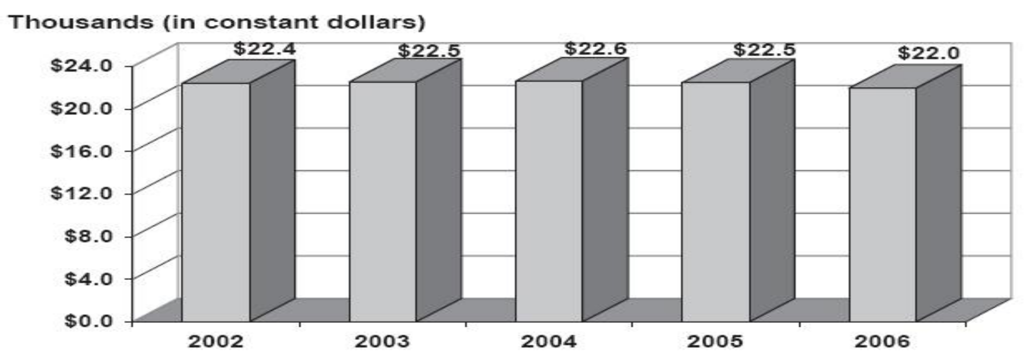
Key Consumer Trends in the U. S. Financial Industry

Introduction

Most market forecasts suggest a slower pace of economic growth in the first half of 2008.[i] Federal Reserve Chairman, Ben Bernanke, notes that consumer spending "appears to have slowed significantly," while higher energy prices and a weakening job market could weigh further on consumption. "The business sector has also displayed signs of being affected by the difficulties in the housing and credit markets," notes Mr. Bernanke. Financial markets, meanwhile, remain under "considerable stress," he adds, and officials will monitor financial developments "closely."

In its quarterly economic forecasts released last week, the Fed downgraded its 2008 gross domestic product forecast by 0.5 percentage point to a range of 1.3 percent to 2 percent. That's even further below what officials expected back in July." The incoming information since our January meeting continues to suggest sluggish economic activity in the near term," says Mr. Bernanke.[ii]



	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Personal Income (millions)	$8,397	$8,787	$9,158	$9,541	$9,896
Consumer Price Index	178.2	182.1	186.1	191.7	199.0
Population (in thousands)	210	214	218	221	226
Net Constant Dollar Personal Income (in 000s)	$22.4	$22.5	$22.6	$22.5	$22.0

Sources: CAFR Table XVI. US Bureau of Labor Statistics for All Urban Consumers.

Calculation: (Per Capita Income * Population)/CPI/Population *100

This paper looks at these issues and trends from a consumer perspective and focuses on four key areas: mortgages, baby boomer retirement, consumer confidence and banking trends.

Mortgages

Subprime horror stories dominate the headlines in the new year as falling home prices, a softening in housing demand, overbuilding, interest rate resets, growing defaults and tightening lending standards wreak havoc in the residential market. Subprime borrowers with low teaser rates of 7 percent to 8 percent may see rates jump as high as 11 percent when they reset. Even conventional borrowers with ARM and hybrid mortgages could face a crunch, especially those who stretched their finances to buy a home, those who took advantage of loose lending standards by taking out big loans without showing documented proof they could afford it, and those whose home values have plummeted below the mortgage amount. [iii]

The housing market impacts the macro economy through many channels, most directly through construction jobs and home-building activity, and spending on furniture and appliances by families moving into new or existing homes. No channel has been more important of late – or more controversial – than housing wealth. According to many prominent economists, including former Fed Chairman, Alan Greenspan, the extraction of home equity wealth in recent years has propped up consumer spending. A sudden swoon in housing prices, they warn, could shut off this spigot, prompting a sharp cutback in spending and elevating recession risks. [iv]

Mortgage companies that offer Home Equity Lines of Credit or 'second mortgages' find themselves in a particularly awkward position in today's market. Millions of homeowners that have a Home Equity Line of Credit have little or no equity left on their homes, others reside in depreciating markets and still others have taken out the stated income. In the event of a foreclosure, estimated to number in the range of 2 million in 2008, the primary mortgage holder is financially compensated first and "IF" there is any remaining money available, it goes to the second mortgage holder. Often times the second mortgage holder receives little or no compensation.[v]

Baby Boomer Retirement

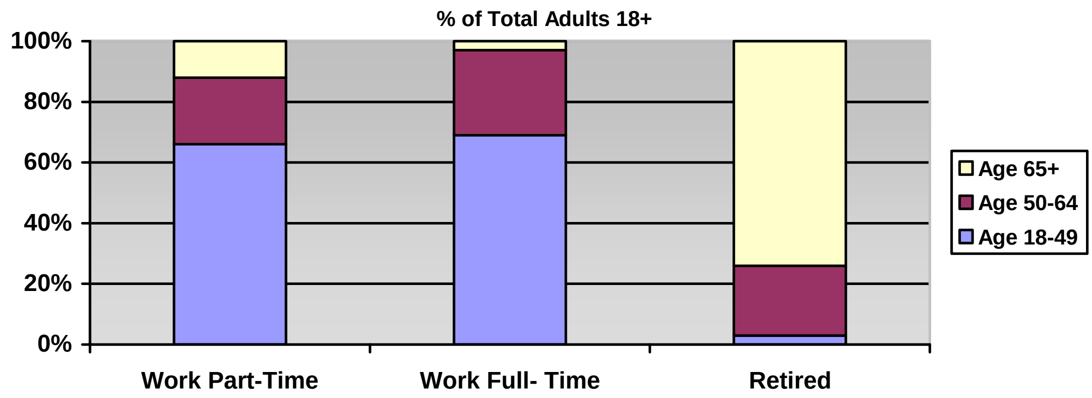
The estimated 78.2 million baby boomers in the U.S. comprise the generation born between 1946 and 1964.[vi] Within the decade, age 50+ consumers will control the economy for the first time in history. By 2015, the boomers will command almost 60 percent of the net U.S. wealth and 40 percent of spending. In many categories, boomers will represent over 50 percent of consumption and will comprise a majority of share growth. Compared to previous generations, boomers have spent significantly more throughout their lives, and their spending peaks later in life.[vii]

During the 1990's, the most rapid growth of the older populations in the US occurred in the oldest age groups. The population 85 years and over increased by 38 percent, for example.[viii] With average life expectancy at an all-time high, 77.4 years, more and more Americans over 50 consider middle age a new start on life. Fewer than 20 percent say they see themselves stopping work altogether as they age, according to a recent Merrill Lynch & Co. survey of boomers. Of those who plan to keep working at least part-time, 67percent said they'll do so to stay mentally active, and 57 percent said to stay physically active. People currently in their 50's may well work longer than any previous generation, with more than 60 percent of men, age 60 to 64, expected to be in the workforce in 2012, up from 54 percent in 1992, according to the Bureau of Labor Statistics.[ix]

Longer life spans after retirement place an extra burden on people to save adequately for retirement during their working years. Reduced levels of family member support resulting from smaller sized families, long-term reductions in retirement ages, decline of employer-provided benefit pension plans and medical coverage, increasing health care costs and uncertainty around the future of Social Security all call for later retirement and a more sophisticated understanding of financial management, better risk management and careful planning for long-term healthcare issues to ensure that retirees are able to maintain the lifestyle to which they are accustomed.[x]

Two major long-predicted shifts in workforce demographics – a substantial aging of the workforce and a diminishing number of younger workers – leave employers today facing unique human resource challenges. While there is a potentially abundant age 50+ workforce, with many showing indications of choosing to continue working beyond the traditional retirement age of 65, a smaller pool of younger workers follows close behind.[xi]

A 2004 Phased Retirement Survey conducted by Watson Wyatt Worldwide reveals that two-thirds of surveyed workers between ages 50 and 70 prefer to phase down into part-time work rather than leave the workforce completely.[xii]



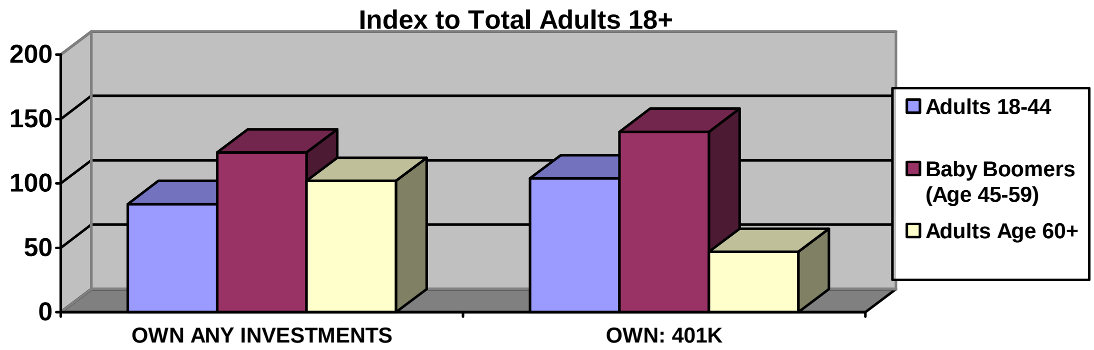
Source: Simmons National Consumer Study, Spring 2007

One of the drivers for American workers to continue to work after retirement is a concern about their source of income once retired, with 92 percent believing the current Social Security program to be in some degree of trouble. Retired respondents agree, but to a lesser extent: 84 percent have lost faith in the program, even though 70 percent rely on Social Security and pension plans "heavily" for retirement income.[xiii]

That older people have more difficulty finding a job, find the jobs harder to perform and endure longer periods of unemployment, supports the contention that eroding pensions and insufficient post-retirement income was a contributing factor to working after retirement.[xiv]

Ed Redfern Jr., AARP New York Associate State Director offers a more balanced view, "A lot of people haven't saved properly for retirement and are going back to work for financial reasons. But people also are living longer, are healthier longer, want to stay engaged, want to be useful and involved in their community."

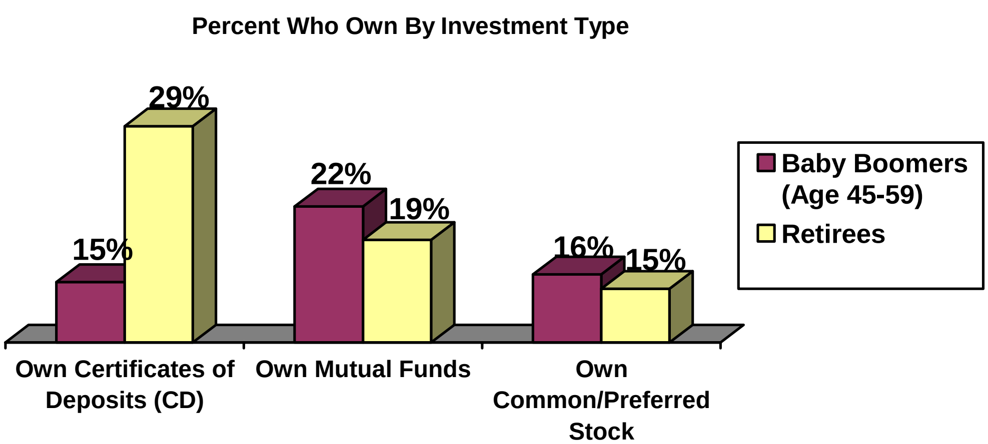
Postponing retirement can make a big difference in retirement income. According to University of Pennsylvania Professor of Economics Richard W. Johnson, working an additional year increases annual retirement income about 9 percent on average while working an additional five years boosts annual retirement income about 56 percent. The impact of working longer is even larger for people at the lower end of the income brackets.[xv]



Source: Simmons National Consumer Study, Spring 2007

While the general perception is that older workers are wary of the stock market, particularly after the recent bear market, today's 50-somethings actually have nearly two-thirds of their retirement savings in stocks, according to a study of 401(k) plans by employee benefits consultants Hewitt Associates. The average 60-something has around 60 percent in stocks. Investors have a strange tendency to be "overly aggressive until the day they retire," says Mike Scarborough, president of the Scarborough Group, a 401(k) investment advisory service. "Then they become overly conservative. It's like a light switch."[xvi]

The chart below with data from the Simmons National Consumer Study confirms the tendency of the retired to be much more conservative in terms of their investment choices, as evidenced by their mix of investment vehicles.



Source: Simmons National Consumer Study, Spring 2007

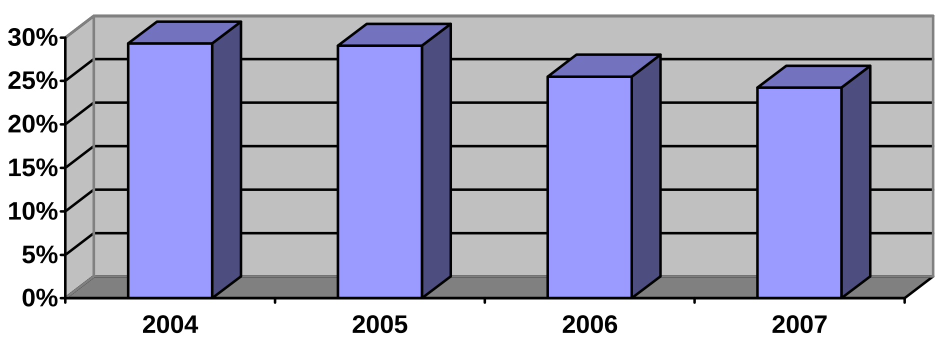
Consumer Confidence

"Looking ahead, consumers are quite downbeat about the short-term future and a greater proportion expect business conditions and employment to deteriorate further in the months ahead," says Lynn Franco, Director of The Conference Board Consumer Research Center.[xvii]

The decline in confidence indicates that pledges of tax rebates and lower interest rates have failed to ease Americans' concerns about falling home and stock prices as well as rising unemployment. To help boost the economy, President George W. Bush signed a $168 billion stimulus package in mid-February, including tax rebates to more than 130 million households, after a deal with Democratic lawmakers.[xviii]

The Simmons National Consumer Study confirms a corresponding drop in consumer confidence (see chart below).

Adults With High Consumer Confidence*



*Adults who have a consumer confidence rating of 6 – 8 on Simmons Consumer Confidence Scale (1= low consumer confidence, 8 = high consumer confidence). This factor aggregates a respondent's opinion of their past and future economic well-being as well as their perception of the US economy's direction in the next 12 months.

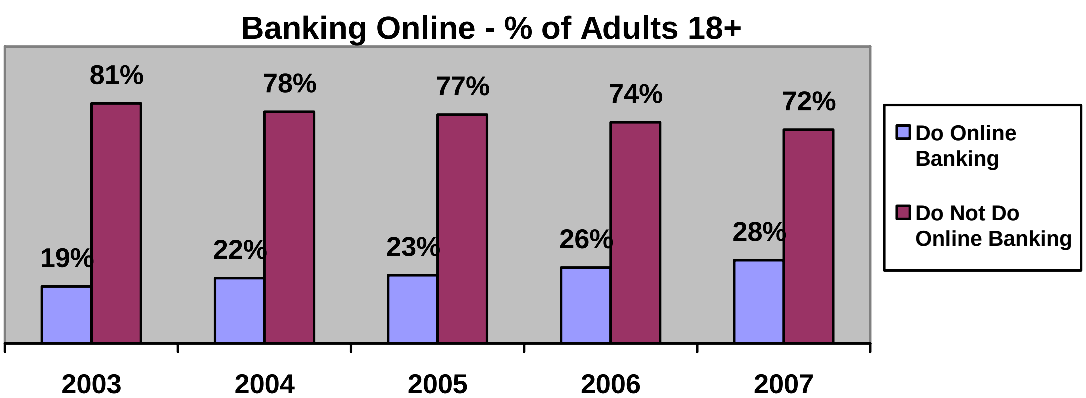
Source: Simmons National Consumer Studies, Spring 2004 - 2007

With energy prices marching upward, the Fed now expects inflation to be between 2.1 percent and 2.4 percent this year. That's higher than its previous forecast for inflation, estimated at 1.8 percent to 2.1 percent. Oil prices in mid-February jumped to a new record - topping $100 a barrel. Consumer prices, meanwhile, rose by a bigger-than-expected 0.4 percent in January, according to new government figures released a few days later. [xix] Excluding the volatile prices of energy and food, consumer prices dropped 2.5 percent lower, remaining significantly above the Federal Reserve's unofficial comfort zone of 1 to 2 percent.[xx]

Banking Trends

Online & Mobile Services

While the majority of U.S. consumers seem to prefer traditional paper statements with only 28 percent doing online banking in 2007, attitudes are changing. Just over half (57percent) believe that Internet banking services are secure, indicating some potential for rapid online banking growth (see chart below).



Source: Simmons National Consumer Study, spring 2004 - 2007

This opportunity has not been lost on the major players in the financial industry, who have demonstrated agility and innovation in reaching out to more tech-savvy customers.

“Social media is a very targeted approach," says Tim Collins, SVP of experiential marketing at San Francisco-based Wells Fargo. "There are what we describe as 'interested communities' -- it could be anything from people who are focusing on what to do in their retirement, which obviously would skew a little older, to what concerts they may want to see this weekend, and that might skew a little younger. Each one of them is a very targeted endeavor, so there is not any broad audience." [xxi]

Bank of America launched free mobile banking services to its 21 million online banking customers. The service allows consumers to use their cell phones and smart phones to check account balances, pay bills and transfer money with the launch of secure mobile banking. "We're taking convenience and control to a new level by providing customers with the ability to stay connected with their finances even when they're on the go," explains Sanjay Gupta, e-Commerce executive for Bank of America.[xxii]

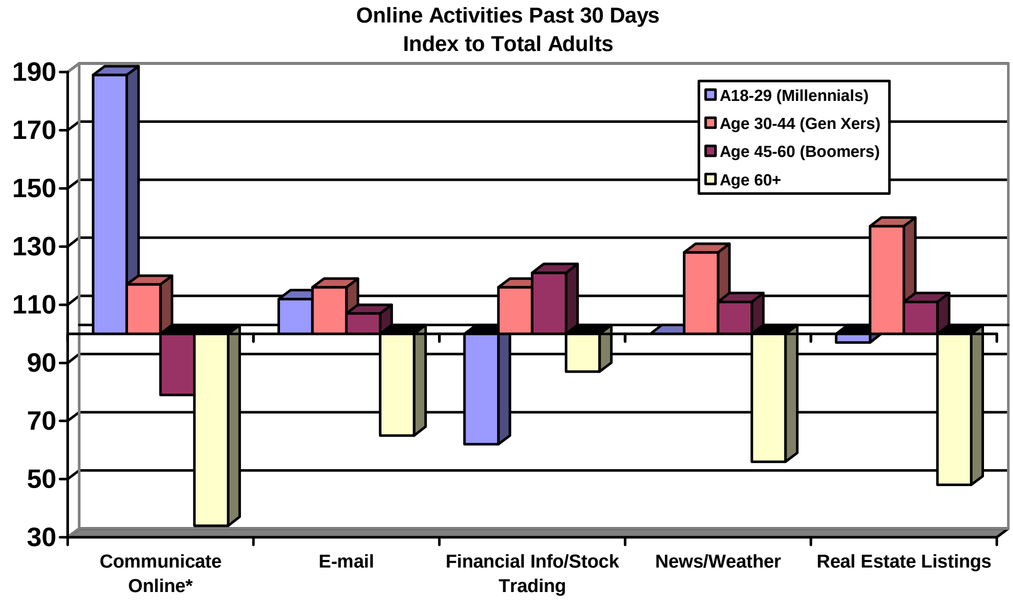
Through the Chase + 1 program, users earn rewards points simply by getting a card, referring a friend, and other actions. Points can be redeemed for DVDs and other student-oriented merchandise. Best of all, earned points can be shared with others or donated to charitable causes or campus groups. "For us, this is an opportunity to establish a life-long brand and business relationship," says Manning Field, Senior Vice President of Branding and Advertising for Chase Card Services. He reports that the partnership with Facebook allows Chase to reach students considering their first credit card while tapping into the social networking phenomenon.[xxiii]

Generation Y/ Echo Boomers/ Millenials

Generation Y, estimated to number 70 million across the US, has unique values and aspirations and considered increasingly important to the financial industry.[xxiv] For a glimpse of unique values, 81 percent of 18- to 25-year-olds surveyed in a 2007 Pew Research Center poll say getting rich is their generation's most important or second-most-important life goal; 51percent say the same about being famous.[xxv]

Gen Y spends upwards of $170 billion annually. "There are more people in that age bracket than there have been since the boomers," says Samantha Skey, Senior Vice President of Strategic Marketing for Alloy Media and Marketing in New York City, which focuses on targeted media and promotional programs. "We're living in a much more densely populated time."[xxvi]

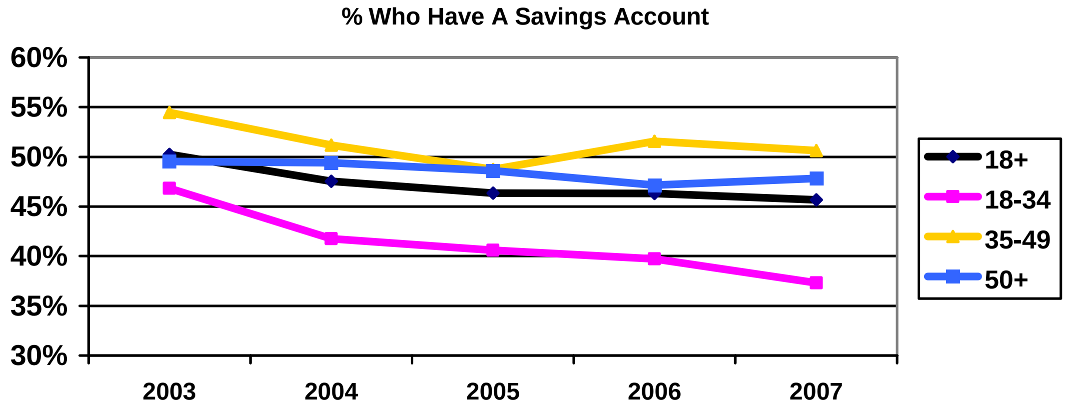
Research by the Fortino Group predicts that current 10 to 17 year olds will spend one third of their lives (23 years) on the Internet.[xxvii] This has helped make social networking one of the most popular tools with this generation. According to Yankee Group, 72 percent of teens actively log on to social networking sites. They meet friends on MySpace and Facebook; communicate by e-mail, mobile phone and text messages; and get their information from Web sites such as Wikipedia. To market to them, experts agree, you have to go to those virtual places where they congregate and communicate with them the same way they communicate with each other.[xxviii]



Source: Simmons National Consumer Study, spring 2007

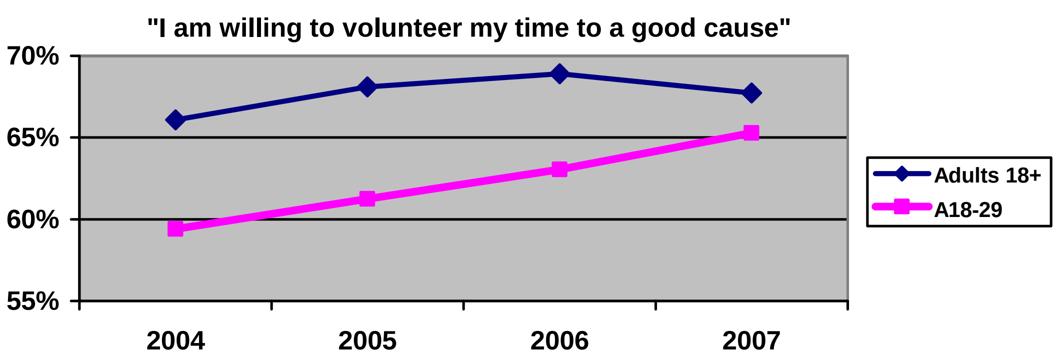
There seems to be an opportunity for financial institutions to build deeper relationships with Gen Y consumers. American Banker cited surveys finding that Gen Yers are less loyal to banks in favor of better services, and as comfortable as older people in using online banking services. The survey ranks large banks from the consumer survey and an expert suggests that they take a small-banking approach to market themselves to Gen Y.[xxix]

Younger adults are less likely to have traditional savings accounts than they were four years ago. This trend is also seen with non-interest bearing checking accounts. However, money market accounts and interest bearing accounts among this generation have remained steady over the same time frame.



Source: Simmons National Consumer Study, Spring 2007

In terms of values, Gen Yers seem to share a strong commitment to social responsibility, as 61 percent of 13 to 25-year olds feel personally responsible for making a difference in the world, suggests a survey of 1,800 young people to be released today. It states that 81percent have volunteered in the past year; 69 percent consider a company's social and environmental commitment when deciding where to shop, and 83 percent will trust a company more if it is socially/environmentally responsible. The online study — by two Boston-based companies, Cone Inc. and AMP Insights — suggests these millennials are "the most socially conscious consumers to date."[xxx]



Source: Simmons National Consumer Study, Spring 2007

Focus on Customer Service

A personal banking survey finds that most bank customers have high levels of overall satisfaction with their banks, reflecting a new emphasis on convenience and service. Several major bank chains now refer to branches as stores, taking a cue from other retail establishments with large glass windows and airy floor plans. Inside branches, consumers may find coffee bars, extended operating hours, well-stocked bookshelves or even a yoga class.[xxxi]

At the same time, customers seem increasingly dissatisfied with bank fees that have risen and multiplied over the past several years. In the face of decreasing interest rates and stiff competition for loans, most consumer banks have increasingly relied on an income stream of fees on everything from ATM transactions to overdrafts to shore up their bottom line. In 2005, the 8,833 banks insured by the Federal Deposit Insurance Corporation pocketed non-interest income of almost $222 billion from fees – an almost 10 percent increase from the year earlier.[xxxii]

Conclusion

In times when consumers seem uncertain about the future, and seem prone to tighten their belts as a result – smart financial services institutions see an opportunity to bring valuable prospects in and bring profitable customers closer.

There are countless examples of how smart financial services institutions have leveraged advertising and branding to effectively tap into the concerns, lifestyles and psychographic traits of key demographic groups. Financial services marketers have used these insights to better understand consumer motivations to more effectively connect with potential and existing customers.[xxxiii]

The current economic climate gives strong financial companies who are first movers an opportunity to pick up market share. By leveraging the 60,000+ data variables on consumer behaviors, opinions, attitudes, and psychographics available in the Simmons Local Consumer Study and the Simmons National Consumer Study - financial service companies have been able to more accurately target their most profitable prospects, tailor both the message and channel.

The additional capability of ERS to deliver online real-time leads gives financial services organizations a fast and efficient way to connect one on one with their most valuable prospects.

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