

Senior Financial Officer Survey on Retail Mutual Funds¹

Summary

While banks have brokered mutual fund shares and advised mutual fund companies for many years, their marketing of mutual funds to retail customers is a more recent phenomenon. The System conducted a Senior Financial Officer Survey in late March and early April to determine the extent to which retail customers now have access to mutual funds at their banks.² The survey requested information on the availability of retail mutual funds and related services, changes in offerings and sales of bond and stock funds, and the nature of retail proprietary and private-label products at respondent banks.³ As bond and stock mutual funds become more accessible, retail depositors may be more willing and able to transfer assets between deposits and these funds. One implication of the enhanced ability to make transfers is that movements in the monetary aggregates may increasingly reflect shifts between monetary and nonmonetary assets rather than changes in underlying macroeconomic forces.

Nearly all of the banks in the panel currently market mutual funds to retail customers or plan to begin to do so in the next two years. Those banks marketing funds to retail customers offer a wide range of products. Most sell proprietary funds as well as nonproprietary or third-party funds: only a few offer private-label funds. While over half of the banks have marketed mutual funds to retail customers for six years or more, about one-third began a retail marketing program within the last three years. However, services linking retail deposits with mutual funds, such as cash management accounts, are limited.

Even though the panel banks typically have been marketing retail mutual funds for several years, the availability of mutual funds at those banks has increased substantially during the past few

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² Fifty-six banks provided responses to the March 1993 Senior Financial Officer Survey. These banks are drawn from every Federal Reserve District and are generally among the largest in each District. Conclusions from this survey should not be used to characterize the overall involvement of banks in the retail mutual-fund market given that no small- or medium-sized banks are represented.

³ A glossary of key terms is located after the survey results.

years. More banks are marketing funds, and the size and availability of their sales forces have increased. While most retail customers still do not own mutual funds purchased through their bank, the share has risen from levels seen three years ago.

The increased availability of stock and bond funds at banks may have had some impact on money growth. Those banks that were confident that they could measure the inflows into mutual funds that were from deposits at their institution estimated that roughly one-third to two-thirds of the inflows were from that source. Most banks reported that their sales of bond and stock funds were stronger in 1992 than in 1991, with virtually all the banks attributing the increase, in part, to the relative attractiveness of bond and stock fund yields. Banks appear to have encouraged these increased sales with more vigorous marketing efforts.

The last part of the survey inquired about proprietary funds. Banks have started marketing proprietary bond and stock funds to retail customers more recently than their overall activity in the retail market. Consequently, retail sales of proprietary bond and stock funds remain fairly thin, although sales of proprietary money market mutual funds are more substantial.

Respondents were asked to characterize the proprietary or private-label U.S. government or other high-grade bond fund that experienced the largest net inflows in 1992 from retail customers. These funds typically have intermediate average maturities and nearly all charge front-end load fees but not back-end or redemption fees. The total of other fees averages about 80 basis points (annual rate). The median minimum initial investment is \$1000. Most of these funds do not have check-writing features.

Availability of Mutual Funds

Mutual funds are widely available to retail customers through the banks on our survey panel. All but four of the fifty-six respondents currently market mutual funds to retail customers, and one of the four banks not marketing mutual funds anticipates doing so in the next two years (Question 2). Nonproprietary or independent funds are sold to retail customers at nearly all the banks, and most respondents also offer proprietary mutual funds (Question 3). Private-label funds are sold by only a few institutions. A wide range of funds are available to customers with all of them

offering bond and stock funds, and most offering money market mutual funds and mixed stock and bond funds (Question 4).

While the panel banks offer a broad range of mutual fund products to their retail clientele, services linking retail deposits with mutual funds remain limited. Only 25 percent of the banks offer retail sweep accounts whereby funds in a depositor's account in excess of a predetermined amount are automatically invested in a money market mutual fund or some other uninsured investment vehicle (Question 1). Over half of the banks offering this service began to do so within the past two years, and the share of their retail customers with such an account is less than 1 percent.

About a quarter of the banks market retail cash management accounts (Question 8). These product lines package traditional and nontraditional banking products, which may include a transaction account, credit or debit card, and a brokerage or mutual fund account. Of the banks not currently offering cash management accounts, about three-fifths plan to do so in the next two years. The least common service offered is access to mutual funds through ATM machines, with only 6 percent of the banks marketing mutual funds offering this service, which is suitable primarily for money market mutual funds (Question 9). However, about one-third of the banks not offering the service expect to do so within the next two years.

The availability of mutual funds at the banks in the panel has increased substantially during the past several years. While half of the banks began to market mutual funds to retail customers six or more years ago, a third of the panel began marketing these products only within the past three years (Question 5). Three-quarters of the banks marketing funds to retail customers have sales representatives located at branches, and the availability of sales personnel has increased dramatically (Question 7). Three years ago over half of the banks that now have sales representatives located at branches had no sales personnel available on a daily basis. Now half of the banks marketing funds through their branches have sales staff available on a daily basis at over 20 percent of their branches. The median percentage of branches with sales representatives available on a periodic basis or by appointment was under 20 percent three years ago but has risen to over 90 percent.

This increased availability of mutual fund sales representatives targeting retail customers also is reflected in the size of the sales forces at banks (Question 10). Three years ago 10 percent of the banks with retail programs had sales forces with over 50 people. Currently two-fifths of the banks have sales forces of this size. The most common marketing agent is a subsidiary or affiliated brokerage firm, with three-quarters of the respondents using such an agent; roughly two-fifths of the banks also rely on NASD licensed branch or bank employees to market retail funds (Question 6). Third-party vendors and trust departments were each listed by one-quarter of the banks. Despite the increased availability of sales representatives, most retail customers do not own mutual fund shares purchased through their banks, although the proportion has increased during the past three years (Questions 11 and 12). Three years ago, less than one percent of most banks' depositors owned mutual fund shares acquired through their banks, but the median share has increased slightly to between 1 and 5 percent.

Bond and Stock Mutual Fund Sales

The heavy inflows into bond and stock mutual funds apparently have held down retail deposit growth. However, the extent of this phenomenon has been difficult to quantify. The median response of banks that were very or moderately confident that they could estimate the percentage of inflows into all mutual funds that were from deposits at the bank reported that between one-third and two-thirds of the inflows were from their own deposits (Question 13). Most banks characterized their sales of bond and stock funds in 1992 as being stronger than in 1991 (Question 14). All of the banks attributed the stronger inflows, at least in part, to lower rates on bank deposits, and eighty percent to attractive returns on mutual fund shares as well.

About three-quarters of the respondents experiencing stronger inflows attributed the change partly to increasing awareness that such funds were available to retail customers through the bank: over three-fifths also cited aggressive promotion of mutual funds and more accessible sales representatives as factors contributing to the heavier inflows. These bank-specific reasons are consistent with over 90 percent of the banks characterizing their efforts to sell bond and stock mutual funds as being more vigorous relative to efforts three years ago (Question 15). More than

one-half of the banks attributed the more vigorous marketing efforts to the increased profitability of bond and stock mutual funds, and slightly less than half attributed the changed stance to declining profitability of traditional banking activities. Only about one-quarter of these respondents cited reduced regulatory barriers to offering these products. Two-thirds of the banks offered other rationales, with most citing increased consumer demand.

Proprietary and Private-Label Funds

The marketing of proprietary and private-label stock and bond mutual funds to retail customers appears to have lagged the overall marketing of mutual funds. Half of the respondents offering such products reported initiating the marketing of them just within the past two years (Question 16). Hence, retail inflows into the proprietary bond and stock funds as a share of all inflows are quite small. Over half of the banks offering these funds reported that less than 10 percent of their retail bond and stock fund inflows were into their proprietary products (Questions 18 and 19). Proprietary money market mutual funds garner a larger share of the retail inflows, with half of the banks reporting that those funds receive over 60 percent of the inflows (Question 20). The light inflows to proprietary and private-label stock and bond funds also are reflected in the responses to Questions 21 and 22, where banks were asked to report the net inflows from retail customers and the total assets held by retail customers in the banks' proprietary and private-label products. Apart from the money market mutual funds, the median net inflows and the amounts outstanding typically were small.

Focusing on funds that potentially could be the closest substitutes for bank deposits, the survey asked banks to provide characteristics of proprietary or private-label high-grade bond funds (Question 17). Thirty-four banks offer such a fund. The median average maturity of the fund is 5-1/2 years. Most of these banks reported charging a front-end load fee, with the median fee being 3.75 percent. Only one bank reported offering a fund with a back-end load fee. Eight of the funds have check writing features, with the median minimum balance being \$500. The median initial investment is \$1000. The median total fee charged by funds is 78 basis points. The medians reported for gross redemptions, sales, assets at the end of 1991, and assets at the end of 1992 were relatively small.

In view of the continuing weak growth of retail deposits, particularly the ongoing runoff of retail CDs, the Federal Reserve System is seeking information from depository institutions concerning the evolving nature of their retail-deposit markets. This survey is designed to gather information about the availability of mutual funds to retail depositors through banks.

1. a. Does your bank offer **retail** sweep accounts whereby funds in a depositor's account in excess of a predetermined amount are automatically invested in a money market mutual fund or some other uninsured investment vehicle?
 - a. Yes, into money market mutual funds
 - b. Yes, into retail repurchase agreements
 - c. Yes, into other uninsured instruments (specify _____)
 - d. No

Number of Banks (Percent)

Yes, into MMMFs	Yes, into retail RPs	Yes, into other instruments	No	Total Banks
14 (25.0)	1 (1.7)	0 (0.0)	42 (75.0)	56

If you answered no, go to question 2.

- b. When did your bank first begin to market such sweep accounts to retail customers?

Number of Banks (Percent)

Within the past 2 yrs.	2 to 3 yrs. ago	4 to 5 yrs. ago	6 to 7 yrs. ago	More than 7 yrs. ago	Total Banks
8 (57.1)	0 (0.0)	3 (21.4)	0 (0.0)	3 (21.4)	14

- c. Approximately what share of your retail customers currently have such an account?

Number of Banks (Percent)

Less than 1%	1 to 5%	6 to 10%	Over 10%	Total Banks
10 (71.4)	3 (21.4)	1 (7.1)	0 (0.0)	14

2. a. Does your bank market mutual funds to retail customers?

Number of Banks (Percent)

Yes	No	Total Banks
52 (92.9)	4 (7.1)	56

If you answered yes, go to question 3.

- b. Does your bank plan to market mutual funds to retail customers in the next two years?

Number of Banks (Percent)

Yes	No	Total Banks
1 (25.0)	3 (75.0)	4

Complete the remainder of the survey only if your bank currently markets mutual funds to retail customers.

3. What kinds of mutual funds are available?

Number of Banks (Percent)

Proprietary	Private Label	Independent or third party	Total Banks
45 (86.5)	5 (9.6)	47 (90.4)	52

4. What types of mutual funds does your bank offer?

Number of Banks (Percent)

Bond-tax exempt	Bond-taxable	Stock	Money market-tax exempt	Money market-taxable	Mixed bond and stock	Total Banks
52 (100.0)	52 (100.0)	52 (100.0)	50 (96.2)	49 (94.2)	46 (88.5)	52

5. When did your institution first begin marketing mutual funds to retail customers?

Number of Banks (Percent)

Within the past 2 yrs.	2 to 3 yrs. ago	4 to 5 yrs. ago	6 to 7 yrs. ago	More than 7 yrs. ago	Total Banks
12 (23.1)	4 (7.7)	10 (19.2)	12 (23.1)	14 (26.9)	52

6. How does your bank principally market mutual funds to retail customers? (more than one answer may apply)

- a. Through a subsidiary or an affiliated brokerage firm
- b. Through NASD licensed series six or series seven branch/ bank employees
- c. Through a third party vendor
- d. Through your bank's trust department
- e. Other (specify _____)

Number of Banks (Percent)

Through a subsidiary	Through NASD	Through a third party	Through trust department	Other	Total Banks
40 (76.9)	22 (42.3)	14 (26.9)	14 (26.9)	2 (3.8)	52

7. a. Are mutual fund sales representatives located at your bank's branches?

Number of Banks (Percent)

Yes	No	Total Banks
40 (76.9)	12 (23.1)	52

If you answered no, go to question 8.

- b. Approximately what share of your bank's branches have mutual fund sales representatives available to retail customers on a daily basis?

Number of Banks (Percent)

None	Less than 5%	5 to 10%	11 to 20%	21 to 40%	41 to 60%	61 to 80%	81 to 100%	Total Banks
3 (7.5)	4 (10.0)	5 (12.5)	8 (20.0)	12 (30.0)	1 (2.5)	2 (5.0)	5 (12.5)	40

c. Approximately what share of your bank's branches had mutual fund sales representatives available to retail customers on a daily basis three years ago?

Number of Banks (Percent)

None	Less than 5%	5 to 10%	11 to 20%	More than 20%	Not located at branches	Total Banks
10 (25.0)	15 (37.5)	3 (7.5)	4 (10.0)	0 (0.0)	8 (20.0)	40

d. Approximately what share of your bank's branches have mutual fund sales representatives available to retail customers on a regular basis (or by appointment) but not on a daily basis?

Number of Banks (Percent)

0 to 20%	21 to 40%	41 to 60%	61 to 80%	81 to 90%	91 to 95%	More than 95%	Total Banks
5 (12.5)	4 (10.0)	3 (7.5)	3 (7.5)	5 (12.5)	2 (5.0)	18 (45.0)	40

e. Approximately what share of your bank's branches had mutual fund sales representatives available to retail customers on a regular basis (or by appointment) but not on a daily basis three years ago?

Number of Banks (Percent)

0 to 20%	21 to 40%	41 to 60%	61 to 80%	81 to 90%	91 to 95%	More than 95%	Not located at branches	Total Banks
14 (35.0)	5 (12.5)	4 (10.0)	0 (0.0)	1 (2.5)	1 (2.5)	7 (17.5)	8 (20.0)	40

8. a. Does your bank offer retail cash management accounts that link traditional bank deposits with nontraditional bank products?

Number of Banks (Percent)

Yes	No	Total Banks
15 (28.8)	37 (71.2)	52

If you answered yes, go to question 9.

b. Does your bank plan to market such a product to retail customers within the next two years?

Number of Banks (Percent)

Yes	No	Total Banks
19 (57.6)	14 (42.4)	33

9. Can your bank's retail customers transmit and receive funds in connection with customer orders to purchase and redeem shares of mutual funds through your bank's ATM machines?

- a. Yes
- b. No, but the bank expects to offer this service in the next two years.
- c. No, and the bank does not expect to offer this service.

Number of Banks (Percent)

Yes	No, but expects to offer	No, does not expect to offer	Total Banks
3 (5.8)	16 (30.8)	33 (63.5)	52

10. a. Approximately how many mutual fund sales representatives does your bank have who target retail customers?

Number of Banks (Percent)

Under 50	50 to 100	Over 100	Total Banks
31 (59.6)	10 (19.2)	11 (21.2)	52

b. Approximately how many mutual fund sales representatives targeting retail customers did your bank have three years ago?

Number of Banks (Percent)

Under 50	50 to 100	Over 100	No retail sales force existed 3 yrs. ago	Total
37 (71.2)	4 (7.7)	1 (1.9)	10 (19.2)	52

11. Approximately what share of your retail depositors own mutual fund shares acquired through your sales representatives?

Number of Banks (Percent)

Less than 1%	1 to 5%	6 to 10%	11 to 15%	More than 15%	Total Banks
19 (37.3)	28 (54.9)	3 (5.9)	1 (2.0)	0 (0.0)	51

12. Approximately what share of your retail depositors owned mutual fund shares purchased through your bank three years ago?

Number of Banks (Percent)

Less than 1%	1 to 5%	6 to 10%	More than 10%	Total Banks
44 (88.0)	5 (10.0)	1 (2.0)	0 (0.0)	50

13. a. How confident are you that you can measure the percentage of the inflows to mutual funds at your bank that were from retail deposits at your bank in 1992?

Number of Banks (Percent)

Very confident	Moderately confident	Unsure	Total Banks
12 (23.1)	25 (48.1)	15 (28.8)	52

- b. Approximately what percentage of the inflows to the mutual funds through your bank do you estimate come from your retail deposits in 1992?

Number of Banks (Percent)

Over 2/3	Between 1/3 and 2/3	Less than 1/3	Total Banks
8 (21.6)	24 (64.9)	5 (13.5)	37

Complete the remainder of the survey only if your institution offers bond or stock mutual funds to retail customers.

14. a. How would you characterize bond and stock mutual fund sales to retail customers at your bank in 1992 (as compared with 1991)?

Number of Banks (Percent)

a. Much stronger	b. Somewhat stronger	c. About the same	d. Somewhat weaker	e. Much weaker	f. Did not offer in 1991	Total Banks
33 (66.0)	11 (22.0)	1 (2.0)	0 (0.0)	0 (0.0)	5 (10.0)	50

If you answered c, d, or e, go to question 15. If you answered f, go to question 16.

b. What are some of the more important reasons for stronger sales?

- a) Attractive returns on the mutual fund shares
- b) Lower rates on bank deposits
- c) More aggressive promotion of funds (including referrals to sales staff)
- d) Wider range of funds available
- e) More accessible sales representatives
- f) Increasing awareness that such funds are available to retail customers through your bank
- g) Other (specify _____)

Number of Banks (Percent)

Attractive returns on mutual fund shares	Lower rates on bank deposits	More aggressive promotion	Wider range available	More accessible representatives	Increasing awareness of availability	Other	Total Banks
35 (79.5)	44 (100.0)	27 (61.4)	13 (29.4)	28 (63.8)	34 (77.3)	11 (25.0)	44

15. a. How would you characterize your bank's efforts to sell bond and stock mutual funds to retail customers compared with three years ago?

Number of Banks (Percent)

Much more vigorous	Somewhat more vigorous	About the same	Somewhat less vigorous	Much less vigorous	Total Banks
34 (75.6)	7 (15.6)	4 (8.9)	0 (0.0)	0 (0.0)	45

b. If your bank's efforts to sell bond and stock mutual funds to retail customers are more vigorous than three years ago, to what would you attribute this changed stance?

- a) Increased profitability of such activities
- b) Reduced profitability of traditional banking activities resulting from higher capital standards and deposit insurance premiums.
- c) Reduced regulatory barriers to offering these products
- d) Other (specify _____)

Number of Banks (Percent)

Increased profitability of such activities	Reduced profitability from traditional banking	Reduced regulatory barriers	Other	Total Banks
22 (53.7)	18 (43.9)	11 (26.8)	27 (65.9)	41

Complete the remainder of the survey only if your bank markets proprietary or private label mutual funds to retail customers.

16. When did your bank first begin to market proprietary or private label mutual funds to retail customers?

Number of Banks (Percent)

Within the past 2 yrs.	2 to 3 yrs. ago	4 to 5 yrs. ago	6 to 7 yrs. ago	More than 7 yrs. ago	Total Banks
22 (50.0)	5 (11.4)	9 (20.5)	6 (13.6)	2 (4.5)	44

17. What are the characteristics of your proprietary or private label U.S. government or high-grade bond fund that experienced the largest net inflows in 1992 from retail customers?

If your bank does not market such a fund to retail customers, check in the space provided and go to question 18. _____

	Banks	75%	Median	25%
Average maturity of the portfolio (years)	32	7.25	5.5	4
Front-end load (percent)	28	4.5	3.75	3
Back-end load (percent)	1		1	
Does the back-end load diminish over time?	1		Yes	
Redemption fee (percent)	1		1	
Does this fee diminish over time?	1		Yes	
Check writing features: yes ___ minimum amount	8	500	500	500
no ___	26			
Minimum initial investment	34	2500	1000	1000
Annual account fee	2	60 bp		25 bp
Management fees	31	65 bp	50 bp	35 bp
12b-1 fees	17	30 bp	25 bp	25 bp
Other fees	18	30 bp	20 bp	12 bp
Total fees	33	94 bp	78 bp	60 bp
Gross redemptions (\$ Millions)	16	20.0	11.3	4.7
Gross sales (\$ Millions)	22	51.4	20.4	8.5
Total assets at end of 1991 (\$ Millions)	24	104.5	37.6	16.7
Total assets at end of 1992 (\$ Millions)	29	185.0	67.0	39.7

18. Approximately what share of your bank's retail sales of **bond mutual funds** are of your bank's proprietary and private label funds?

Number of Banks (Percent)

0 to 10%	11 to 20%	21 to 40%	41 to 60%	61 to 80%	81 to 90%	91 to 100%	Total Banks
23 (52.3)	5 (11.4)	6 (13.6)	2 (4.5)	3 (6.8)	0 (0.0)	5 (11.4)	44

19. Approximately what share of your bank's retail sales of **stock mutual funds** are of your bank's proprietary and private label funds?

Number of Banks (Percent)

0 to 10%	11 to 20%	21 to 40%	41 to 60%	61 to 80%	81 to 90%	91 to 100%	Total Banks
25 (56.8)	2 (4.5)	3 (6.8)	3 (6.8)	3 (6.8)	2 (4.5)	6 (13.6)	44

20. Approximately what share of your bank's retail sales of **money market mutual funds** are of your bank's proprietary and private label funds?

Number of Banks (Percent)

0 to 10%	11 to 20%	21 to 40%	41 to 60%	61 to 80%	81 to 90%	91 to 100%	Total Banks
15 (34.1)	3 (6.8)	2 (4.5)	1 (2.3)	4 (9.1)	2 (4.5)	17 (38.6)	44

21. What were the net flows (in millions of dollars) into your bank's various proprietary and private label investment products in 1992 from retail customers?

	Total Banks	75%	Median	25%
Taxable money market mutual funds	24	152.5	15.7	2.2
Nontaxable money market mutual funds	22	23.0	5.4	1.5
Stock mutual funds	22	40.0	4.0	1.9
Taxable bond mutual funds	22	65.5	4.3	1.6
Nontaxable bond mutual funds	21	26.0	5.5	0.7

22. What were the total assets (in millions of dollars) of your bank's various proprietary and private label investment products in 1992 held by retail customers?

	Total Banks	75%	Median	25%
Taxable money market mutual funds	25	277.0	210.0	53.5
Nontaxable money market mutual funds	25	100.0	60.0	15.6
Stock mutual funds	27	56.0	11.0	2.3
Taxable bond mutual funds	26	73.8	9.4	2.4
Nontaxable bond mutual funds	23	86.3	10.5	1.2

Glossary

Cash management account - A product line offering a package of traditional and nontraditional banking products that may include a transaction account, a savings account, a credit/debit card, a brokerage or mutual fund account, or an automated sweep arrangement

Market - To sell actively rather than to offer a product passively.

Retail customer - A client other than a corporation, business, or trust department (a noninstitutional client)

Proprietary mutual funds - Funds advised by the bank or an affiliate of the bank

Private label mutual funds - Funds sold exclusively through the bank but not advised by the bank or an affiliate

Third party mutual funds - Mutual funds other than proprietary or private label funds