Becoming a nation of savers

Keeping families out of debt by helping them prepare for a rainy day

A Discussion Paper

Contents

Executive summary

Families are facing a savings crisis. Nearly 22 million adults in Great Britain are not confident they are saving enough to cope with a rainy day. At the moment these people don't see how they are going to be able to start saving either; 75% (16.3m) aren't confident they will be able to start saving enough for a rainy day within the next year[1].

This report shows this lack of financial resilience is worse for younger families on low-moderate incomes, living in rented accommodation or with young children.

These families need savings. In earlier research, StepChange Debt Charity has shown that if every household in Great Britain had at least £1,000 saved it would reduce the number in problem debt by 500,000. Considering problem debt comes with a social cost of £8.3bn, the value of helping families save would be considerable[2].

A combination of low income and high outgoings is one factor preventing many families from saving and building resilience. But economic influences are not the only ones in play. A significant minority of households in all segments of society do manage to save. Our new research confirms previous analysis that behavioural barriers, such as bounded rationality, inertia and procrastination also prevent saving.

The policy challenge is to get families saving by helping them overcome economic and behavioural barriers. The goal should be to improve financial resilience and reduce the level of problem debt by ensuring all families have a minimum of at least £1,000 saved to help them cope during a 'rainy day'.

Incentives, such as auto-enrolment, matched funding and prize-links have been used successfully in the UK and other countries to get families saving. We must use these incentives again to solve the savings crisis.

There already exists in the UK an incentive-based scheme for getting people saving: auto-enrolment for pensions with a matching element, where government and employers increase the pot of money available for saving. However, this scheme does not help families build up short term precautionary savings. We have previously argued that it should be adapted to do so.

This new discussion paper builds on our earlier work to:

- Show, via new research, which families in the UK are least likely to have enough saved for a rainy day.

- Offer options for how the pension auto-enrolment system could be adapted to deliver £1,000 savings for these families and others, using proven incentives from successful savings schemes around the world, and without significantly reduced retirement income for individuals, or increased costs to employers, pension schemes or the public purse.
- Call on financial services firms to consider products with similar features, including for people who don't have access to the auto-enrolment system.
- Suggest how the welfare system could be evolved so that the benefits of saving could be extended to people on benefits.

Our key recommendation is that the auto-enrolment system for pensions should be adapted to encourage individuals to put aside limited amount of precautionary saving before the age of 55. This could be done either by creating an accessible savings 'jar' within a pension pot, or by diverting auto-enrolment contributions into a linked savings account. This new system would harness behavioural incentives to ensure families save the amount they need but also use incentives to encourage them to maintain their savings balance for moments of greatest need.

More needs to be done however. Financial services providers and government need to help families who are not part of the auto-enrolment system, either because they fall below the relevant income thresholds or because they don't have an employer. This report proposes further policy solutions that would help this group directly.

We want firms to work with us to develop and pilot saving accounts better suited for individuals who can only start saving with a low initial deposit and only make intermittent deposits subsequently. They should explore greater use of saving incentives such as prizes but which are effective for lower-income families.

Government should seek to build a savings element into the welfare system; for example, via income thresholds and work allowances within tax credits and Universal Credit. It should do more to get children saving to ensure the UK builds a precautionary savings culture in the long term. Finally, the existing proposal that families recovering from a debt emergency should be allowed to save to ensure they stay debt free in the future should be enhanced by:

- Formalising the saving from a provision in the individual's budget to a deposit in an accessible savings vehicle.
- Ensuring creditors and essential services providers are fully engaged with the process.

- The FCA explicitly acknowledging the benefits of saving in a client's budget, as long as the consequences are fully explained to clients in terms of taking longer to pay down debt.

There is much to do to overcome the savings crisis. But considering the benefit having a 'rainy day' fund brings to struggling families, it must be overcome. The UK already has many of the tools needed at its disposal to make the attempt a success. It should use them.

Recommendations

Recommendation 1: The government should set a target for all families in the UK to have at least £1,000 in accessible cash saving.

Recommendation 2: The government should work with employers, pensions providers and banks to allow struggling savers to build a rainy day saving buffer via the pensions auto-enrolment system. There are features of the model which would benefit from piloting, to test the effectiveness of different combinations of incentives

Recommendation 3: Banks should explore, develop and ultimately pilot savings accounts which allow families to access headline savings rates and offers even if they can only open accounts with a small deposit and only pay in small, irregular amounts.

Recommendation 4: Financial services providers should explore the use of prize-linked savings accounts which appeal to lower-income consumers.

Recommendation 5: Government should build a saving element into the welfare system via work allowances and income thresholds in Universal Credit and tax credits.

Recommendation 6: Government should expand current trials of credit union accounts for primary pupils, linked to financial education, into secondary schools.

Recommendation 7: Enhance the current proposal to include a savings element in the budgets of people receiving debt advice to resolve financial difficulties by: a) formalising the saving from a provision in the individual's budget to a deposit in an accessible savings vehicle; b) ensuring creditors and essential services providers are fully engaged with the process; and c) the FCA explicitly acknowledging the benefits of saving in a client budget, as long as the consequences are fully explained to clients in terms of taking longer to pay down debt.

Why should families save?

Having accessible savings:

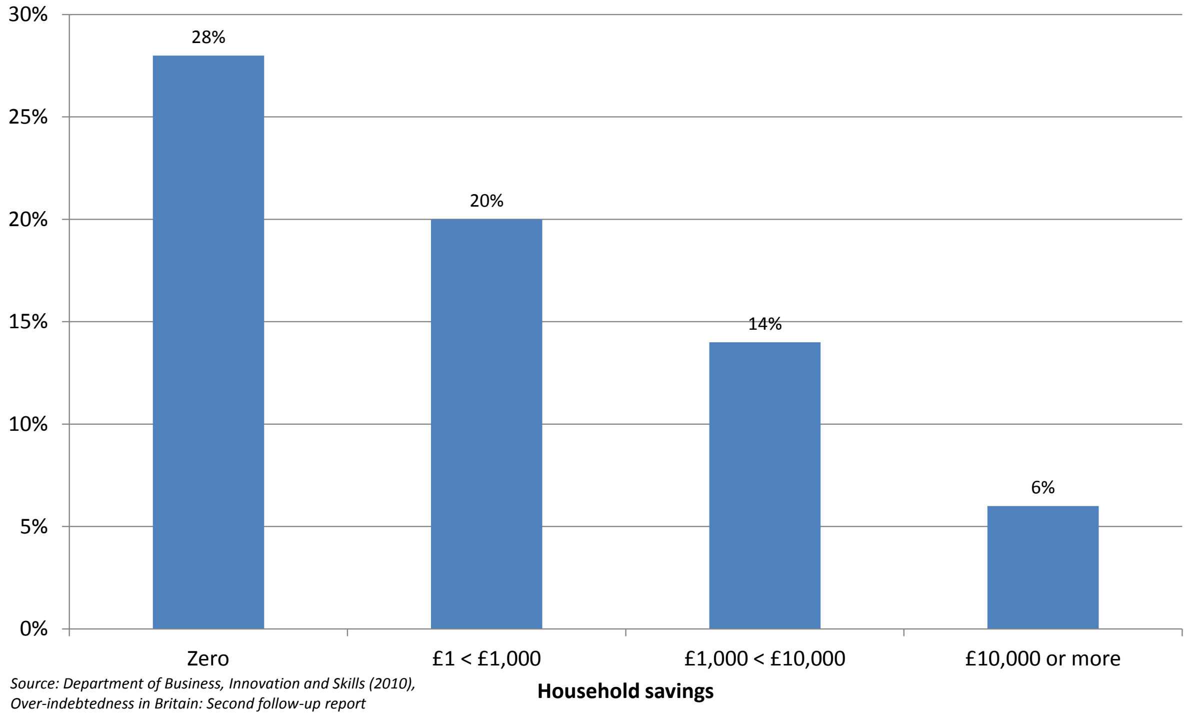
- Helps families avoid problem debt.
- Promotes financial inclusion.
- Leads to wider social benefits regarding employment, healthcare and children's life prospects.

Preventing problem debt

Families without accessible cash savings can find it hard to pay an unexpected bill, or get through a period with reduced income, or without income, without it leading to a long term financial crisis[3]. When faced with income challenges, these families are often forced to use credit to pay household expenses, leaving them in danger of falling into problem debt. This is especially dangerous when the credit used is high cost.

Data from 2010 shows 28% of households with zero savings have a very high debt-to-income ratio (60% or more). This reduces to 6% of borrowing households with savings over £10,000[4].

Figure 1: Unsecured debt-to-income ratio of 60% or more



Source: Department of Business, Innovation and Skills (2010), Over-indebtedness in Britain: Second follow-up report

Over a third of households with zero savings say that they find keeping up with bills a 'heavy burden', compared with 3% of households with savings over £10,000[5].

In January 2015 StepChange Debt Charity released ONS Wealth and Assets Survey (WAS) data showing for a household with an average net annual (regular) income of £25,000, the odds of problem debt is estimated to be 44% lower if the household has cash savings of £1,000, 72% lower if the household has cash savings of £5,000, and 84% lower with cash savings of £10,000[6]. For households with a lower regular income, the protective effect of savings is slightly higher – meaning that for lower income households having accessible cash savings is even more important than it is for more affluent households.

The research indicates that across the UK, increasing accessible cash savings to £1,000 in households with lower current savings levels would reduce the number of households estimated to be at risk of problem debt by approximately 500,000[7]. Considering the current social cost of debt to the UK is estimated to be £8.3 billion, the value of this change would be considerable[8].

Financial inclusion

Millions of households across the UK are excluded financially. For example, nearly two million adults in the UK do not have a bank account[9]. Research from the United States shows that where savings products have been designed to appeal to such groups it encourages greater engagement with financial services by those who are currently under-banked[10].

There is evidence that appropriate savings products would perform a similar function in the UK. Evaluation of the first Savings Gateway pilot by Kempson et al[11] showed that 32% of participants had previously only saved informally and not in interest-adding vehicles.

Encouraging financially excluded families into the financial mainstream could help challenge the current situation in the UK where financially excluded people pay a 'poverty premium' of £1,300 each year, by allowing them access to mechanisms such as direct debits[12].

Wider societal benefits

Research on savings has shown it has important positive effects on increasing labour market participation, avoiding marital breakdown, and on health[13]. Increasing savings levels among lower income families has been shown to reduce rates of poverty, and children in households with higher levels of saving have been shown to have better educational outcomes and better employment and income prospects in the longer-term[14].

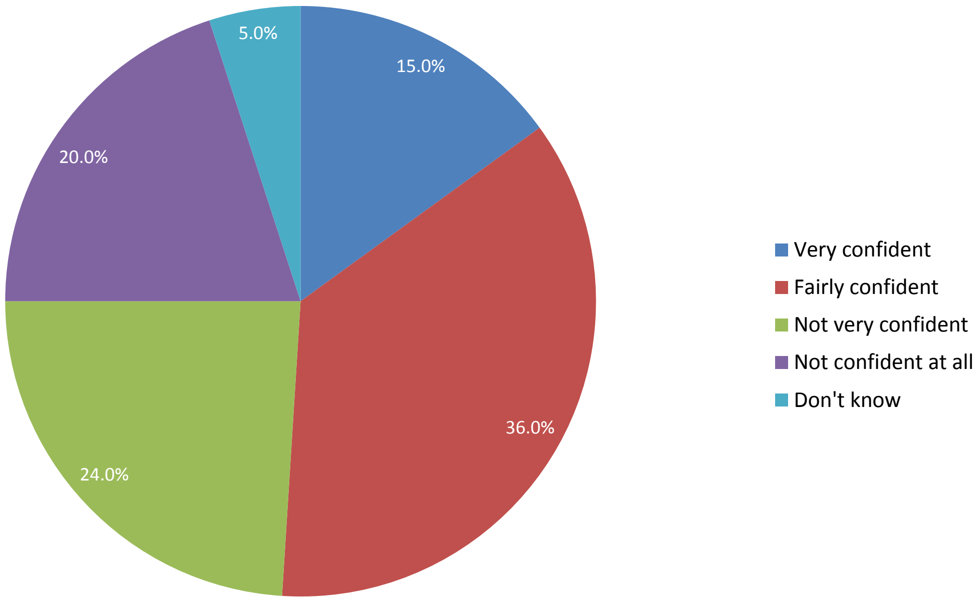
Evidence from the first Savings Gateway pilot demonstrated that most participants, largely lower income, developed savings habits 'they were reluctant to break'[15]. Evidence from the second Savings Gateway pilot built on this by showing that not only were savings habits kept, the habit of saving helped people budget better in order to save[16].

Who doesn't save?

While a recent report from the Financial Conduct Authority (FCA) found 93% of UK households have some type of cash savings, its research showed that the majority of saving is in accounts with a low balance; 50% have less than £10 in them[17]. This is not sufficient to protect families. Analysis of the Wealth and Assets Survey for this report has shown that 29.6% of families in the UK, 7.17 million household, do not have £1,000 saved, an amount we have argued should represent the minimum acceptable household saving safety net.

It is not just that families do not have any money put by. It is that they are still struggling to save. A YouGov survey[18] commissioned by StepChange Debt Charity in July 2015 showed 21.8 million adults in Great Britain (44% of the population) do not feel confident they are saving enough for a 'rainy day'[i]. Three-quarters of these adults do not feel confident they will be able to start saving enough for a rainy day within the next year[ii].

Figure 2: Currently, how confident, if at all, are you that you are saving enough money to cope with a 'rainy day' (e.g. an unexpected bill, period of reduced income or no income)?



[i] Defined as an unexpected bill, period of reduced income or no income
[ii] This is a higher number of adults than the number contained in the 7.17 million households identified by the WAS without £1,000 in accessible cash saving. This is largely because £1,000 represents a minimum acceptable saving amount. Many families will believe they need more than this to withstand a rainy day.

The survey showed significant variation between higher and lower income respondents; 53% of respondents earning under £25,000 a year were not confident they were saving enough for a rainy day, compared with 39% of respondents earning over £40,000 a year.

Other research confirms high levels of saving are almost entirely concentrated in higher income bands. While only 14% of households with an income of less than £13,500 have at least £10,000 saved, half of households with an income over £50,000 do so[19].

A Department of Business, Innovation and Skills (BIS) survey in 2012 found 50% of home owners had high levels of saving, compared with 11% of people living in rented accommodation. Regarding tenure, the indication is that lower-income households living in rented accommodation are particularly unlikely to have formal saving if they rent from a social landlord, or are single parent households[20]. Previous literature also indicates young people are less likely to have savings, as are families with dependent children.

Research: Section 1 - families in the UK without savings

For this report we commissioned new analysis of the latest wave of the Wealth and Assets Survey (WAS)[iii]. The aim was twofold:

- To build on previous data in order to understand which households in the UK are least likely to have accessible cash savings.
- To understand any behavioural factors that might influence their decision not to save.

This research section addresses the first of these aims. The second is addressed below[iv].

Which households don't have enough saved?

The new analysis approaches this question in two ways.

First, it determines the proportion of households with at least £1,000 in accessible cash saving[v] based on of the following socio-economic variables (chosen as a result of a detailed literature review):

[iii] Wave 3, 2010-12
[iv] The methodology for both research sections is contained in Appendix 1. The full Select report can be found on our website at http://www.stepchange.org/Portals/0/documents/Reports/SocioEconomicGroupsAndSaving.pdf
[v] Total household cash/accessible savings were calculated from the WAS data by summing the household value of cash ISAs (not including investment ISAs which includes stocks, shares, life insurance, corporate bonds and PEPs), informal savings (e.g., cash or loose change, given to someone else to look after and save for you, etc.), current accounts in credit and savings accounts

- National Statistics Socio-Economic Classification (NSSEC) of Household Reference Person (HRP) or partner
- Employment Status of HRP or partner
- Number of dependent children
- De facto marital status of HRP or partner
- Tenure
- Type of household (e.g. couple over state pension age, lone parent with dependent children etc.)
- Household net annual (regular) income
- Age of HRP or partner (grouped into 9 bands)
- Whether HRP or partner has longstanding illness, disability or infirmity
- Whether there are any dependent children under the age of 5 in household

We have used £1,000 as the metric for adequate savings as this was the amount identified by our previous research as balancing a positive impact on family resilience, while still being a realistic target. It is broadly consistent with other thinking, for example the Money Advice Service's call on families to save £3 per day, which equates to £1,095 over a year.

Second, the analysis uses 'classification trees' to identify a series of new household types based on the above variables according to their likelihood of having savings[vi].

1. Households with at least £1,000 in cash saving

The new findings support much of the previous research. Overall, the WAS shows 7.17 million households in the UK do not have £1,000 in accessible cash savings. The savings gap – the amount these families need to save in order to each reach £1,000 is £5.36 billion. In particular, there are very low levels of accessible cash saving among households:

- With a lower income[vii].
- Where the home is rented, rather than owned.
- Which contain younger dependent children[viii].

(e.g., Savings or deposit account with a bank or building society, National Savings Easy Access [Ordinary] Account, etc.).

[vi] For example, one household type identified could be households with an income below *x*, with more than *y* children, who live in rented accommodation. These households may be less likely to have savings than a household type with an income above *x*, with fewer than *y* children and who own their home outright.

[vii] Here we define lower-income as households with an income in the lower two quintiles of the WAS income brackets

[viii] A full data set based on all the variables identified above can be found in Appendix 2.

The research also confirms a strong relationship between age and saving, with older households much more likely to have adequate levels of saving (not including pensions).

Income

Less than 55% of households with a net income equal to or less than £14,000 a year have at least £1,000 in accessible cash savings. This only rises to six in 10 families earning between £14,000 and £21,000 a year and around seven in 10 families earning between £21,000 and £30,000 a year.

Table 1	
Household net annual (regular) income	Savings ≥ £1000
x ≤ 14k	54.6%
14k < x ≤ 21k	61.1%
21k < x ≤ 30k	68.5%
30k < x ≤ 44k	79.1%
44k < x	91.3%

Tenure

Only 41% of households living in rented accommodation have at least £1,000 saved. This is far lower than the proportion among families with a mortgage (76.2%).

Table 2	
Tenure	Savings ≥ £1000
Own it outright	91.6%
Buying with mortgage	76.2%
Part rent/part mortgage	66.5%
Rent it	41.3%
Rent-free	77.3%
Squatting	NA

Younger dependent children

Around 72% of households without dependent children under five have at least £1,000 saved, compared with 58% of households with dependent children under five.

Table 3	
Any dependent children under the age of 5 in household	Savings ≥ £1000
No	72.1%
Yes	58.3%

Age

The older the head of a household is, the more likely that household is to have at least £1,000 saved. However, the data shows some key age milestones in regard to accruing savings. Only a third of 16-24 year olds have at least £1,000 saved, compared with 59% of those aged 25-34. There is also an almost 10 percentage point difference in saving levels between those aged 45-54 (67%) and aged 55-64 (77%).

Table 4

Age	Savings ≥ £1000
16-24	33.5%
25-34	58.6%
35-44	60.0%
45-54	67.4%
55-64	77.1%
65-74	82.1%
75-84	83.9%
85+	89.0%

2. Classification trees

A classification tree uses an algorithm to construct new household groups with multiple characteristics. It therefore gives us an idea what socio-economic characteristics have the most bearing on whether a family has savings or not.

Based on the likelihood of have £1,000 cash saving, the classification tree analysis found 12 new "groups". These are based on three of the variables identified above, as these had by far the greatest bearing on saving propensity.

- Tenure
- Household net annual (regular) income
- Number of dependent children

The fact that other variables have not been selected by the classification tree algorithm means that using them as predictor variables in addition to these three does not substantially improve the definition of the different groups.

Group 1, whose members are least likely to have savings, comprises families who live in either rented accommodation or are squatting, and have a household net income less than £35,050. Given the very low number of people in the sample with squatting given as their tenure, we can therefore describe this new group as households living in rented accommodation on a low-moderate income, or *'Low-moderate income renters'*. This is also the group that comprises the bulk of StepChange Debt Charity clients.

The other 11 groups described by this classification tree are defined in table 5. The table shows that income is obviously a significant factor, as we can see that household groups with lower levels of saving tend to have either low or middle incomes. But some lower-income families can and do save, so there are other factors in play preventing saving.

Table 5: Classification tree groups

Group name	Tenure	Household net income	No. dependent children	Savings ≥ £1000	Group number
Low-moderate income renters	Renting or squatting	x < £35,050		36.9%	1
Very low-income mortgage holders	Buying with mortgage or rent free	x < £17,250	0 or 1	58.7%	2
Middle-to-high income parents	Own outright, buying with mortgage, part rent/part mortgage or rent free	x < £51,250	2 or more	66.1%	3
Low-income mortgage holders	Buying with mortgage, part rent/part mortgage or rent free	£17,250 < x < £27650	0 or 1	68.1%	4
Middle-to-high income renters	Renting or squatting	£35,050 < x		69.7%	5
Middle-to-high income mortgage holders	Buying with mortgage or part rent/part mortgage	£27,650 < x < £62650	0 or 1	84.1%	6
Low-income homeowners	Own outright or part rent/part mortgage	x < £17,250	0 or 1	85.0%	7
High-income mortgage holders	Buying with mortgage or rent free	x> £51,250	0 or 1	89.5%	8
Low-moderate income homeowners	Own outright	£17,250 < x < £27,650	0 or 1	92.2%	9
High-income mortgage holders	Buying with mortgage or rent free	£62,650 < x < £78,500	0 or 1	94.6%	10
Middle-to-high income homeowners	Own outright or rent free	£27,650 < x < £62,650	0 or 1	96.5%	11
Very high-income mortgage holders	Buying with mortgage or rent free	x > £78,500	0 or 1	96.5%	12

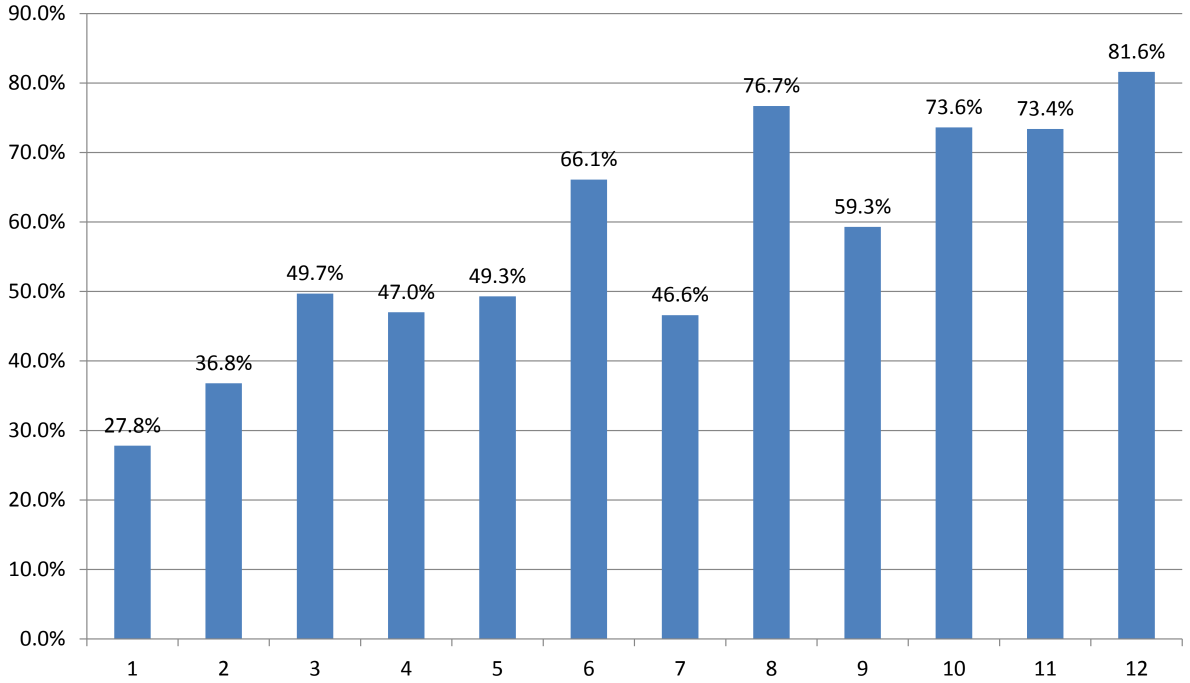
We see again the apparent relationship between home ownership and saving. Where two groups have similar income levels, a far lower proportion of households living in rented accommodation have adequate savings. For example if we look at groups 5 and 9 we can see that group 9 actually has a lower income profile, with households in this group earning annually between £17,250 and £27,650. But group 9 has a higher proportion of savers (92% vs. 69%). By looking at the tenure we can see this significant difference is the fact that those in group 5 are primarily renters, while those in group 9 own their home outright. Further research would need to be done on this area, but we might suggest this is partly due to households that own their home outright having far lower expenditure than households who rent, due to much lower housing costs. There is likely to be an age element as well, with families headed by older people more likely to be homeowners

The classification tree also seems to indicate the impact a greater number of younger dependent children can have.

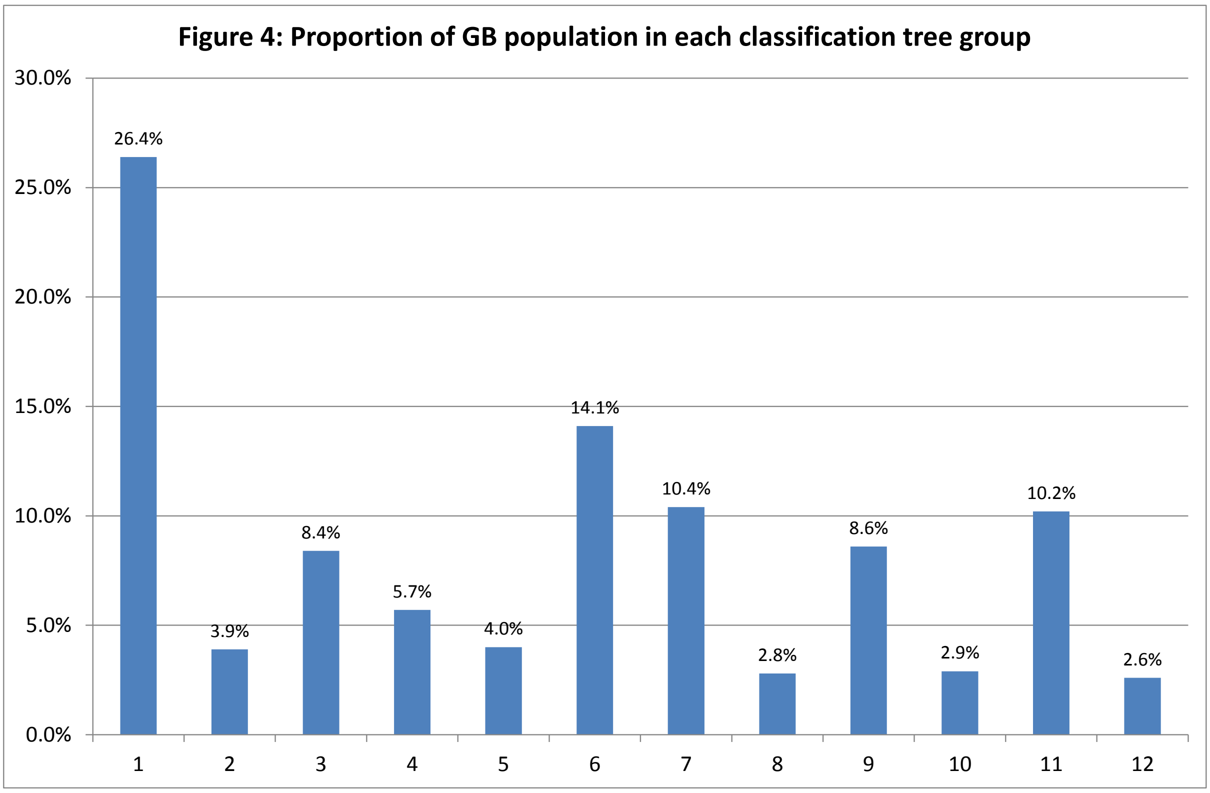
If we examine groups 3 and 8 we can see that the only difference between the two is that members of group 3 have at least two dependent children, whereas the members of group 8 have either only one dependent child or no dependent children. However, while only 58% of the members of group 3 have at least £1,000 saved, in group 8 this equates to 89%.

It should be noted that for each group, the proportion who said they have saved anything in the last two years (as opposed to have any savings at all) was lower than the proportion that currently had at least £1,000 saved. This might reflect the increasingly difficult economic environment over the survey period (2010-2012).

Figure 3: Proportion of classification tree group who have saved any income in last two years



Furthermore, although 12 groups were identified by the classification tree analysis; the size of these groups is not equal. In particular, as Figure 4 shows us, over a quarter of the population are in group 1. As this is the group where the proportion with at least £1,000 saved is lowest it again illustrates that levels of savings across the UK are sub-optimal. Overall, half the households in the UK are in classification groups where over half of members do not have £1,000 saved. This further suggests that current saving incentives work reasonably well for some groups, but less well for others.



What else prevents people saving?

As we can see from this research socio-economic variables are one indicator of whether families are saving or not; in particular, income, tenure and younger dependent children. Any solution to the saving challenge must be aware of this.

However, socio-economic variables are not the only factors preventing people saving formally. Behavioural reasons have also been shown to stop people saving[21]:

- Bounded rationality, i.e. a limit on the amount of information an individual possesses and/or a constraint on their decision-making capabilities
- A tendency towards procrastination
- A tendency towards inertia
- Being loss-averse, for example wanting to have less “take home pay”

In addition, many people who have little engagement with mainstream financial services mistrust financial services providers, or believe the products they offer are not for “people like them”[22]. The fact that many accounts require high deposit levels likely reinforces this belief for many families[23]. This is why a key feature of many savings products that have been shown to appeal to lower-income consumers is the ability to open an account with a very low initial deposit[24].

This is important because it illustrates the response to the saving challenge is not only based on increasing incomes. A policy solution will need to overcome these behavioural barriers, or turn people’s behavioural traits to their advantage.

Research: Section 2 – behavioural motivations for non-saving

In this section we use the WAS to explore the behavioural barriers identified for non-saving and see how they apply in a UK setting. Our new analysis focuses on the 12 groups defined by the classification tree analysis. For each group it ascertained the distribution of responses to four attitudinal questions contained in the WAS, which give some insight into respondents’ financial attitudes and behaviours.

- What were your reasons for not saving in the last two years?
- How strongly do you agree or disagree with the statement “I prefer to buy things on credit rather than save up and wait”?
- How strongly do you agree or disagree with the statement “I am very organised when it comes to managing my money day to day”?
- If you had a choice of receiving £1000 today or £1100 next year, which would you choose?

The result of the analysis supports much of the previous literature and indicates it holds true in a UK context. While an important barrier to saving is often income or expenditure, behavioural factors inhibit savings for many. A significant proportion of households (between 8% and 13%) display financial behaviours that do not prioritise the long term financial advantages associated with saving.

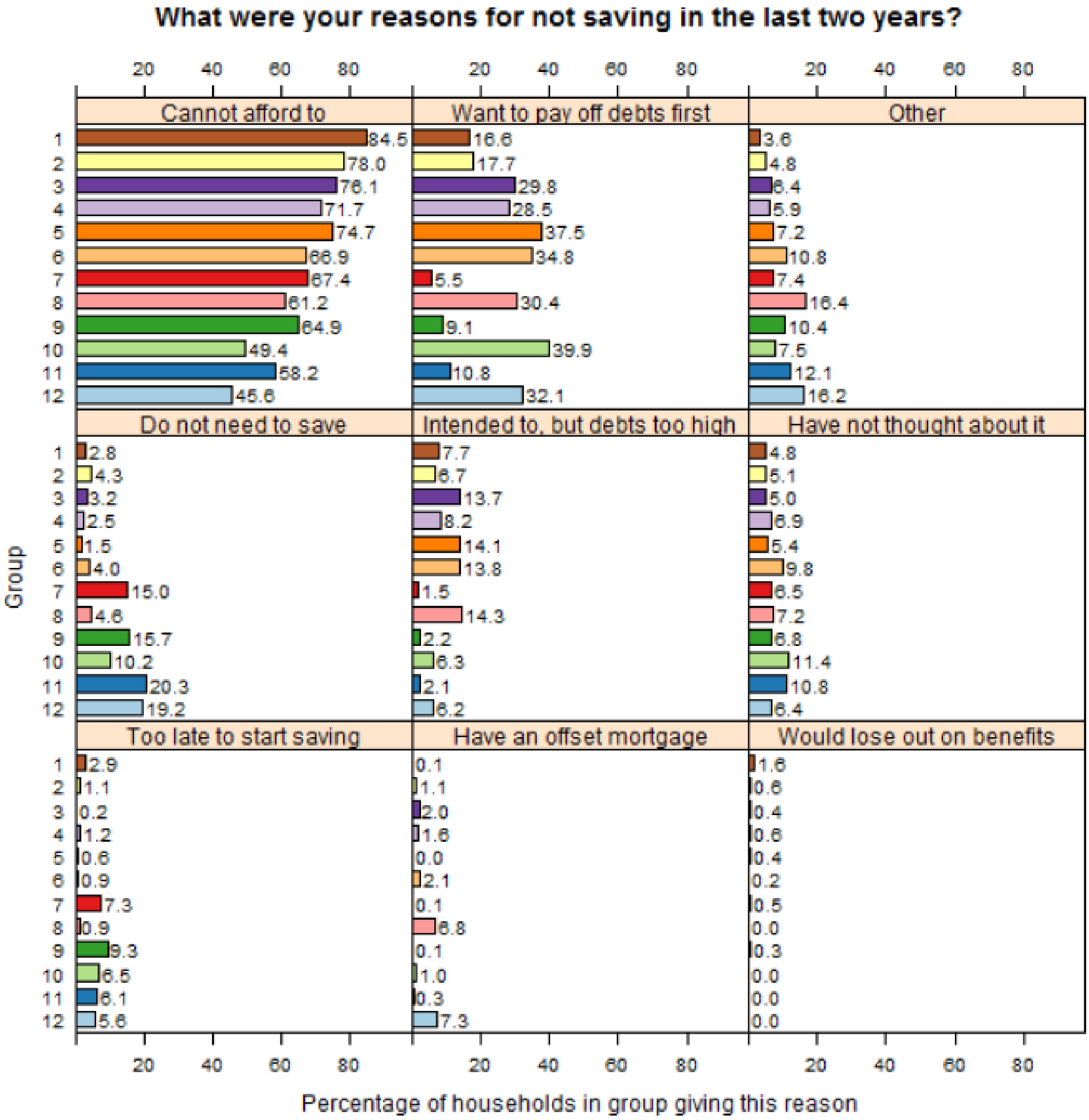
From the perspective of the saving debate there are two further lessons. The first is that it is the groups with less saved tend to display these characteristics slightly more often.

However, the second is that the difference between these groups and those with more savings is not very large. This indicates that while integrating behavioural triggers into savings incentives will be most beneficial to certain vulnerable groups, in the longer-term it may benefit families across the socio-economic landscape. This is a crucial finding because it suggests that products and incentives can be broadly targeted. Experience suggests that initiatives aimed explicitly at “low income consumers” can be undermined if they are seen as labelling particular groups

What were your reasons for not saving in the last two years?

Although it is clear that a low income is a major determinant of poor savings habits, other factors play a big role. When asked to choose from a range of reasons for non-saving, many in the classification groups identified said they did not save because they wanted to pay off existing debts or because their debt repayments were too high to enable saving. A lower proportion, but a still relatively significant number also do not save because they believe they either do not need to save or simply have not thought about it (up to 10% amongst the bottom six classification groups in terms of saving), suggesting a level of inertia or procrastination.

Figure 5



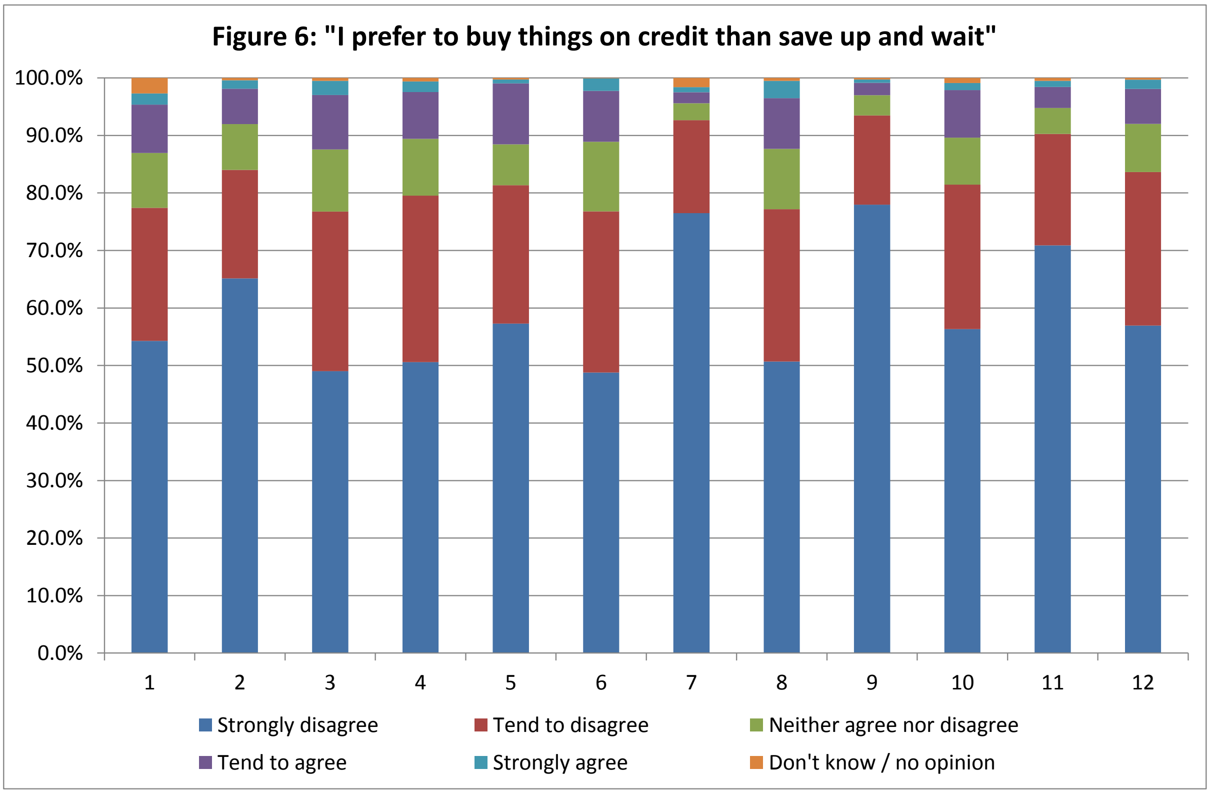
Source: Select Statistical Consultants (2014), Report available on the StepChange Debt Charity website

The other three questions develop understanding of how attitudes to financial matters can impact saving. All three reveal a minority of families make decisions that may not be conducive to their long term financial health.

How strongly do you agree or disagree with the statement "I prefer to buy things on credit rather than save up and wait"?

Depending on classification group, up to 11.9% of respondents tend to agree with this proposition in the WAS.

It is noticeable respondents in the first five classification groups (i.e. those with lower savings levels) are slightly more likely to hold this preference. This is indicative of a level of bounded rationality, as some families may not see it lead to financial difficulty in the long term.

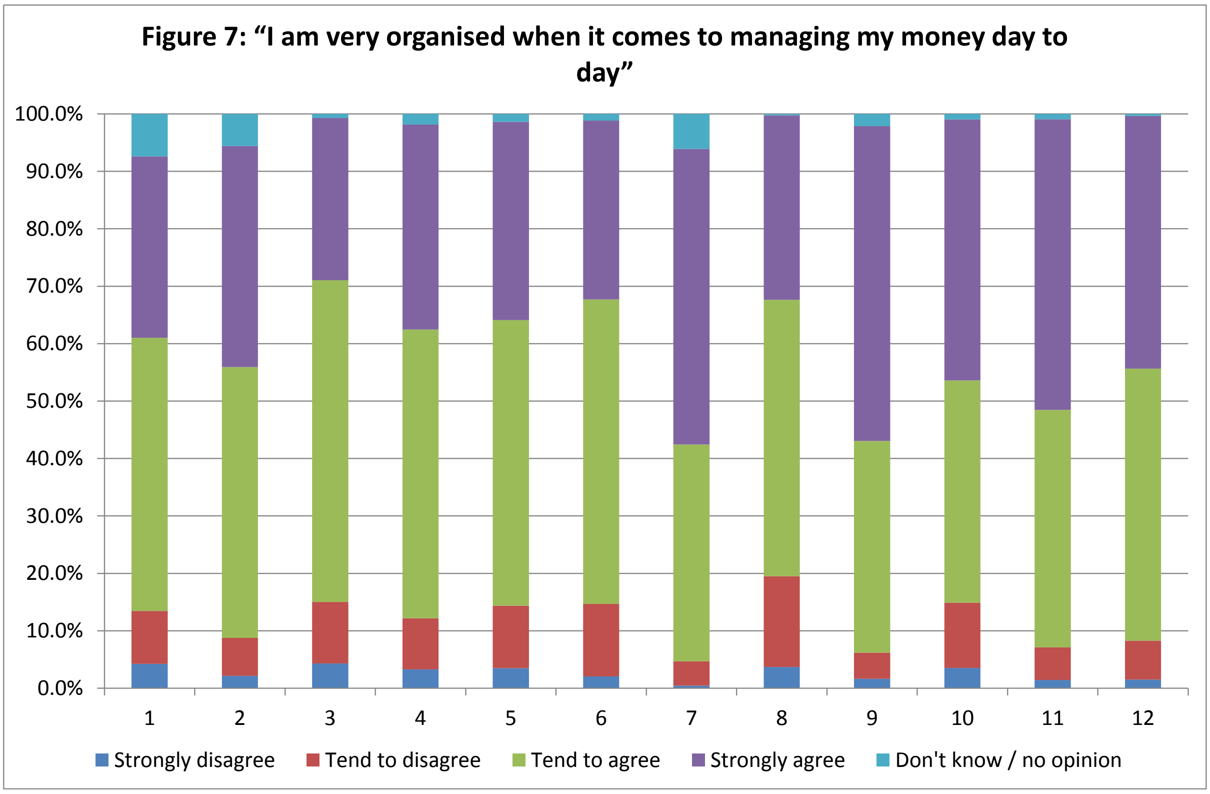


How strongly do you agree or disagree with the statement "I am very organised when it comes to managing my money day to day"?

The majority of respondents in all groups believe themselves to be organised when managing their money day to day.

However, a persistent minority do not think this is the case for their household. Respondents who are part of classification groups that save less are less likely to see themselves as organised when it comes to managing money. This could show bounded rationality, an inability to project over the long term.

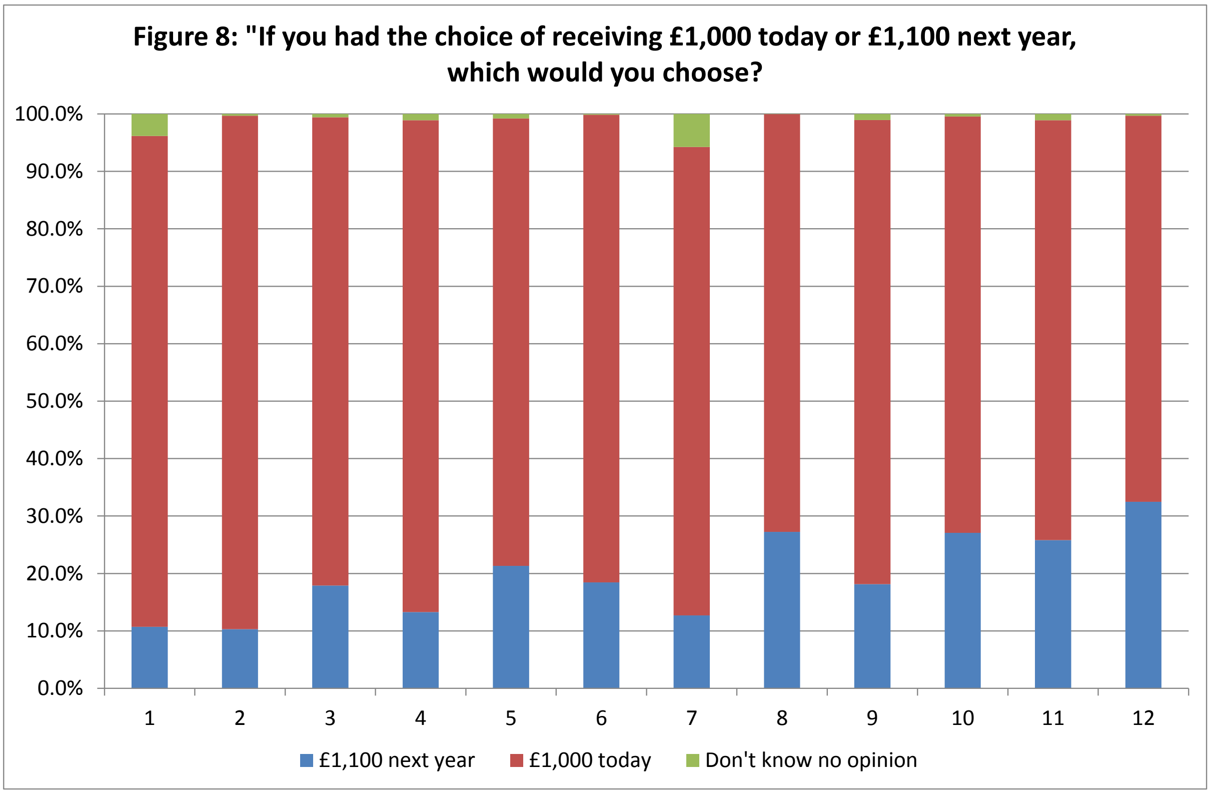
It may also indicate inertia, with families failing to proactively take account of their finances and prioritising immediate term spending over considerations how that spending will reduce their financial freedom in the long term.



If you had a choice of receiving £1,000 today or £1,100 next year, which would you choose?

This question gives an insight into households' longer-term financial thinking. Respondents with a greater capacity for such planning may be likely to go with the latter option. It may also have some bearing on the identified tendency for loss-averse individuals to save less. Loss-averse individuals would most likely take the promise of immediate money, over a potentially risky future windfall[25].

There is a small but obvious difference overall in response from classification groups who save less as opposed to those who save more. In this case those groups that save less are more likely to take £1,000 today as opposed to £1,100 next year.



Conclusion

This research shows the saving challenge has two parts. First, low income (or high expenditure) cannot remain an overwhelming obstacle to saving. Neither can living in rented accommodation or having dependent children. Two, behavioural barriers must either be overcome or harnessed to get people saving.

Incentivising saving

Solutions to the issue of under-saving have been proposed before both in the UK and around the world. These solutions have relied on using incentives to increase the level of savings among struggling families and have shown differing levels of success.

The new policy challenge now is to bring learnings from these solutions together. We discuss various incentive schemes below in pursuit of this, illustrated by case studies of where these approaches have been or are being used.

Prize-linked savings

Prize-linked saving (PLS) schemes, where account holders have the ability to win a prize (e.g. a sum of money) on a regular basis have been shown to appeal greatly to consumers who do not have regular savings habits or who have little existing savings[26]. The popularity of PLS schemes appears to be the blend of a guarantee of no principal loss with a large but low probability gain[27]. This makes them appealing to 'loss-averse' families, who tend to be low-moderate income. PLS schemes seem to be particularly effective when participants have the opportunity to win a prize every time they deposit money, rather than just the ability to win a prize by virtue of having an account[28].

Previous research indicates the particular appeal of prize-linked saving to lower-income families. In 2007, Centra Credit Union in Indiana piloted the first ever prize-linked savings product in the United States across all of its 22 branches. Prior to the full launch, in October 2006, an associated survey was conducted in Clarksville, Indiana[ix]. The survey found 58% of potential participants expressed a positive interest in the PLS accounts, 65% of current non-savers expressed an interest and for people who considered their earnings to be substantially below the local average, 62% expressed an interest[29].

Elsewhere, in 1994 the Jonan Shinkin Bank in Japan introduced prize-linked one-year savings accounts, despite Ministry of Finance disapproval. These accounts attracted deposits worth about $US 305 million into the bank in a matter of days, attracting an additional 13 banks to immediately offer similar products[30]. Writing about PLS accounts in Latin America, Guillén and Tschoegl (2002) conclude that "[T]he bankers we spoke with believe that (the products) are especially successful with low-income depositors." Their review of PLS programs around the world notes that the products appealed to "people outside the banking system[31].

[ix] The county has a mean income 13% lower than the US mean and can provide some insight into PLS demand among low income populations

Case Studies: Prize-linked saving

"Save to Win"

Starting in 2009, Michigan Credit Unions participated in a PLS-based "Save to Win" (STW) pilot. Annually, one participant won a $100,000 grand prize and there were also monthly prize draws. Participants required only $25 to open an account via STW and could subsequently remain enrolled through only depositing small amounts.

This approach proved popular, spreading to 62 Credit Unions over four states, resulting in 40,000 additional members, 79% of whom were classed as "financially vulnerable'[32]. Participants tend to continue saving over a long period – 64% of new savings accounts roll over from one year to the next – whether they are classed as financially vulnerable or not[33].

STW has been shown to be successful helping previous non-savers accrue assets, with participants classed as non-savers growing their average account balance annually by 38%. One main attraction of STW accounts that participants said enabled them to save was the ability to deposit small amounts[34]. In 2013, STW expanded to two new states, Washington and North Carolina, continuing to successfully target lower-income families. Since 2009, STW has had over 50,000 unique accountholders who have collectively saved more than $94 million. Across the United States, more than 1.3 million consumers now have access to the product[35].

Premium Bonds

In the UK Premium Bonds have a nominal interest rate of 1.3%, which instead of being given to any individual bond holder instead goes into a central pot. This pot then forms the basis for monthly prizes available to all bond holders.

Lower-income consumers tend to prefer Premium Bonds to many other saving products – especially if those products could result in an overall loss[36]. However, there are still issues with the design of Premium Bonds as a PLS scheme. Primarily it is an issue that there is a minimum deposit of £100 and that chances to win are linked to the amount invested. The product's lack of any interest if you don't win is also likely to mean it appeals less to those who already have informal savings.

Matched savings

An alternative savings incentive is matching, where for every deposit made by an individual another party (for example, the government or an employer) makes a deposit in the same account. For example, if an individual saves £1 the second party adds a further £0.20 to this, so in effect £1.20 has been saved. Matching is also an effective “frame” for presenting savings incentives, showing greater resonance and behavioural impact than alternative presentations like “tax relief”.

Case studies: Matched saving

Savings Gateway

The Savings Gateway scheme was a UK matched saving product trialled in two pilots in the early-to-mid 2000s.

The first pilot (SG1) operated in five areas of England. In four of these it worked alongside the Community Finance and Learning Initiative (CFLI). Participants came from lower-income groups. Accounts could be opened with £1 and participants could save a maximum of £25 each calendar month. Government matched any savings at a £1 for £1 rate but no interest was paid on accounts.

During the pilot 1,478 accounts were opened, 32% by people who did not previously have any saving account. Half of participants managed to save the maximum possible over the course of the pilot, with a further 19% falling just short.

The evaluation of the pilot found that the main appeal of an SG1 account was the matching element, but that participants would have been attracted by SG1 even if the matching rate had been lower than £1:£1[37].

The second pilot (SG2) was on a much larger scale, with 22,000 accounts opened. These accounts were matched, but unlike the SG1 pilot, not all at the £1:£1 rate. Instead the matching rate varied by area from 20p to £1. SG2 also offered financial education in the form of a CD Rom and tailored courses offered by Learn Direct.

Like the SG1 pilot, the SG2 pilot appeared to be successful in encouraging lower-income families to persist in saving; 71% of participants made a net contribution in at least 16 of the 18 months in which they could save. In total, 61% achieved the maximum government match, and 65% of those who achieved the maximum match continued to contribute to accounts even after the pilot ended[38].

In both pilots matching levels were linked to continued saving, to prevent early or unnecessary withdrawals. More than three withdrawals reduced the final maximum matching rate available. The impact of this design appears to have helped keep the level of withdrawal very low in both pilots[39].

Saving for Education, Entrepreneurship and Downpayment (SEED) Initiative

The SEED Initiative is a US programme offering matched savings accounts to lower-income consumers; 88% of participants earn no more than twice the US poverty line ($23,540 pa for a single household). Unlike the Savings Gateway, while SEED accounts are matched, they are matched on withdrawal only to “help people acquire capital for socially approved purposes"[40]. The SEED Initiative involves heavy social, educational and administrative support.

While overall the SEED Initiative has proved effective in "significantly" improving account holding, savings and assets levels, it has encountered problems. It has proved to be expensive due to the heavy educational and administrative support it involves, with one analysis showing it costs $1.80 for every $1 saved, on top of the matched funding[41]. It has also proved to be relative ineffective in reaching parents on low incomes and, despite the restrictions on matching, 67% of participants have made unmatched withdrawals[42].

Auto-enrolment

Some incentive schemes use defaults to overcome the inertia and procrastination that prevents many people saving. An 'auto-enrolment' workplace saving scheme sees an individual automatically signed up. He or she then must 'opt-out' to stop money being deducted from their pay into a savings account.

Such an approach has proved successful abroad. According to Madrian and Shea[43] one auto-enrolment savings plan they studied in the US increased participation rates from 49% to 86%. Other plans in the US ensured participation rates of over 90%[44].

Case studies: Auto-enrolment

Pension auto-enrolment / National Employment Saving Trust

By 2018, every employer in the UK will need to have a workplace pension scheme in place and start enrolling workers. Although this is not accessible cash saving, it does represent an auto-enrolment product deliberately targeted at increasing savings levels.

The auto-enrolment scheme also contains a matching element, for those enrolled there is matching for their own contributions in the form of an employer contribution and a government contribution (described as tax relief at source).

This scheme was legislated for in the Pensions Act 2008 and amended in 2011 and 2014. Workers are eligible provided they are aged at least 22 and under State Pension age (SPA), and earn over £10,000 per year in 2014/15 terms. The initial matching has been set at a minimum 1% employer contribution as part of a total minimum contribution of 2% until September 2017. Once fully phased in, in October 2018, a minimum contribution of 8% on a band of earnings (£5,772 to £41,865 per year in 2014/15) must be paid in respect of the worker, of which at least 3% must come from the employer and 1% will come from the Government in the form of tax relief. Employers can make a contribution on whole earnings, rather than in a band, as calculating bands can be a costly administrative overhead.

Auto-enrolment into pensions has been a success. Up to the end of September 2014, more than 4.7 million workers have been automatically enrolled by nearly 34,000 employers. Department for Work and Pensions (DWP) research with employers has found that overall, the level of opt out has been broadly consistent since automatic enrolment began in 2012 at around 10%. Qualitative research on auto-enrolment indicates characteristics, such as income, level of employer contribution and part-time or full-time status did not have a consistent impact on opt-out rates[45]. In 2013, there was a rise in pension participation levels across all lower earnings bands with the largest increase (five percentage points) amongst those earning between £10,000 and £20,000, which is just above the automatic enrolment earnings trigger[46].

The success of auto-enrolment is largely due to the way in which it harnesses individual's inertia to ensure they enrol but the matching element and the work done by employers to communicate the scheme also played a key role[47]. Where an employer has made the decision to promote their scheme and make an employer contribution available, take-up was usually higher[48].

The National Employment Saving Trust (NEST) is the default scheme for pension auto-enrolment. It launched on a voluntary basis in 2011 and was prepared for the arrival of employer duties from September 2012. The scheme has a Public Service Obligation (PSO) to accept all employers that want to use the scheme to fulfil either all or part of their employer duties in regards to pensions. This ensures that employer exposure to the costs and risks of choosing a pensions provider are overcome, since there is a government-approved scheme they can use.

The NEST provision also appears to have been a success. The NEST Corporation's annual report 2013-14 highlighted the Corporation's transition from a small pension provider with 80,000 members and £3.8 million assets under management (AUM) in March 2013 to a large pension provider with one and a half million members and £215 million AUM[49].

Tax relief

Tax relief is a key part of current UK policy on savings. While it has been proven to be an effective incentive for those who have a large enough amount to put into an account to make it worthwhile it is less of an incentive for lower-income savers[50].

Case studies: Tax relief

Individual Savings Accounts (ISAs)

Three forms of ISA have the most relevance to the current savings debate.

Cash ISAs: With cash ISAs individuals do not pay tax on savings interest. However, tax relief is not seen as an appealing incentive by lower-income households. This is partly because those with little to save do not get much tax relief, but also because tax-based incentives are not understood well by groups who do not often use financial services[51].

Therefore it is unsurprising that the product is disproportionately accessed by higher-income families. Households earning up to £26,000 - the national average household income - are just half as likely as those earning £50 - £80,000 to have an ISA[52].

Help to Buy ISAs: The March 2015 Budget introduced the first-time buyers' Help to Buy ISA, planned to launch this autumn. For every £200 a first time buyer saves, the government will provide a £50 bonus up to a maximum bonus of £3,000. Savers will be able to withdraw funds from their account if they need them for another purpose but the bonus will only be made available for home purchase. The government bonus can be claimed at any time, subject to a minimum bonus amount of £400.

Corporate ISAs: Like a cash ISA, corporate ISAs enable employees who are resident in the UK and aged 16 or over to save money with interest accrued free of UK income tax. Where they differ is an employer can offer a Corporate ISA to employees on a collective basis, often through a payroll deduction. This approach is a good one when seen in terms of behavioural trends towards inertia, once employees are enrolled they essentially 'auto-save'[53]. However, the corporate ISA shares many of the problems of the basic cash ISA, being complex and better suited to those with more to save. Peak take-up rate for corporate ISAs has hovered at about 5%, so it does not appear to be an immediate solution to the savings challenge[54].

Non-ISA savings accounts

Savings accounts (which can be regular, fixed or easy access) offer either a fixed or varying interest rate over a specified term providing consumers make regular deposits.

Their appeal, at least to those able to make significant deposits, has likely been increased by the announcement at the March 2015 budget that from April 2016 basic-rate taxpayers will be able to earn £1,000 in savings interest before paying any tax and higher-rate payers £500.

These products can be attractive, but in the market there is a confusion of numerous accounts with different terms and conditions, many linked to minimum deposit amounts or initial 'teaser' periods[55]. Since mid-2012 there has also been a fall in the average interest rates that providers have offered to savers[56].

Some providers have attempted to offer more innovative regular savings accounts. For example, one major high-street bank has a prize-linked product, where customers have the chance to win £500,000. However, this product requires a minimum amount saved of £5,000, so is still unsuitable for lower-income consumers.

The policy challenge

In this report and our other work we have argued that the government should set a goal of all families having at least £1,000 in accessible cash savings[57]. Our research suggests this is the point at which savings have the greatest positive impact for the greatest number of families while remaining a realistic target.

The policy challenge is to put in place a system that allows families to save this amount. The system must be sensitive to the circumstances of families struggling to save, but have a wider applicability for the UK population.

Recommendation 1: The government should set a target for all families in the UK to have at least £1,000 in accessible cash saving.

The way forward

There are several reasons families do not save. Important reasons are a lack of income and high expenditure. However, some families do save despite facing these challenges, suggesting there are also behavioural barriers to saving:

- Bounded rationality
- Inertia
- Procrastination
- Loss aversion

At the same time, case studies have demonstrated there are a set of incentives that can help families overcome financial barriers and harness behavioural traits so they can save. The most effective of these appear to be:

- Auto-enrolment
- Matching
- Prize-linked saving

Successful versions of the first two of these incentives already exist in the UK but they are focussed on pensions, not helping people build short term precautionary savings. Instead the main incentive in the UK to encourage short term saving is tax relief. While this is effective for those with a lot to put away, it is less helpful for families who find saving more difficult. It is therefore a deadweight that favours families who would likely have saved anyway.

To assist families who are less attracted by incentives presented as tax relief, the UK will need to re-focus incentives towards helping struggling savers. In addition, financial services providers will need to do more to reach struggling families with products appropriate for their needs. Lastly, it cannot be ignored that saving is particularly difficult for those who are unemployed, or often in and out of work. Savings policy needs to include solutions that will help these groups directly.

This policy discussion will therefore make recommendations in three key areas.

First, it will encourage the government to use the incentive that exists in the current pensions system to enable families to use it to build accessible cash savings.

Second, it will call on banks and other financial service providers to improve their offer to the public to better help struggling families build up an adequate savings buffer.

Third, it will recommend a direction of travel to the government that will help it get unemployed people, or people who are often in and out of work, saving.

1. **Harnessing auto-enrolment to help families save**

A successful auto-enrolment saving scheme already exists in the UK in relation to pensions. While this encourages longer-term saving, these savings are not accessible until an individual is 55[x]. It therefore does little to help families, for whom pension wealth represents their only significant cash saving, avoid problem debt.

However, there are clear reasons for using auto-enrolment as a basis for increasing accessible savings:

- It is already in place and working effectively with a suitable system of earnings thresholds and eligibility requirements.
- Existing workplace savings schemes could be harnessed rather than replaced.
- It is due for review in 2017, which gives an opportunity to make appropriate additions to the scheme.
- It contains an auto-enrolment nudge – reversing the default so people save unless they opt not to, using inertia to deliver good outcomes.
- It contains a match – both employer and tax contributions boost individual saving. If the thresholds and eligibility criteria are kept the same, utilising it will not cost the government any more money. Matching is also a frame people understand.

Recommendation 2: The government should work with employers, pensions providers and banks to allow struggling savers to build a rainy day saving buffer via the pensions auto-enrolment system. There are features of the model which would benefit from piloting, to test the effectiveness of different combinations of incentives.

[x] Except in circumstances where individuals retire early due to ill health.

This is not to say that all pension savings should be accessible at any point. It is crucial that people have an adequate income in their retirement. However, there is little point in somebody having a very limited amount of extra income in retirement if when they reach retirement they have huge amounts of problem debt and have faced a financial struggle for the majority of their working life.

Building a system

An adapted auto-enrolment workplace saving system that builds precautionary savings would need some key features.

Key features of accessible auto-enrolment savings
1. A default amount of contributions that would go into accessible savings rather than inaccessible pension, in order to harness the behavioural nudge of auto-enrolment.
2. The ability to override this default to increase or decrease the proportion of contributions that go into short term saving up to an agreed overall limit[xi]. For example, an override would be needed by people who already have accessible rainy day saving and would create an element of active saving. Active saving means people are less likely to spend savings in a non-emergency[58]
3. Explicit matching for the accessible savings with employers making contributions in response to employee contributions and the government relief at source.
4. A limit on the accessible saving individuals can accrue via pension contributions. In line with our research we suggest this limit could be £1,000. We need to achieve the objective of creating rainy day saving without undermining the goal of improved retirement provision.
5. It will be important to ensure that any accessible savings are not able to be accessed during insolvency proceedings.

We would also want to discourage people from not using their accessible savings too readily. The successful approach of the Savings Gateway pilots, which linked incentives to regular saving in order to prevent early or unnecessary withdrawals, gives a clear example how this could be done.

- The system could have a series of ‘rewards’ built into it, which would encourage savers to continue saving until they reach £1,000 but not to access money until they absolutely needed it.
- Rewards would become available once certain savings ‘thresholds’ had been reached. This:

[xi] Individuals who already had savings could choose to continue with all their contributions going into their inaccessible pension. Couples could choose to divert contributions back into their inaccessible pension when they both had £500 saved.

- Would give participants the feeling they are actively saving, which tends to help people develop a saving habit.
- Would enable them to build up precautionary savings quickly.

- Rewards would also operate in reverse, discouraging inappropriate[xii] withdrawal because they would become unavailable as people spent savings. This:
  - Would prevent government and employer money 'leaking' from the system through people filling their accessible savings jar or account to a low level via matching and then spending it.
  - Would be easier to administer than a prescriptive list of "permitted uses" which would be costly to administer and complex to enforce.

Potential 'rewards' to promote saving but disincentivise early withdrawal

1. **Matching**: Available once an individual had saved a certain amount of their own money.

2. **Prize-links**: PLS appeals to consumers who do not have regular savings habits or who have little existing savings. An auto-enrolment saving scheme incorporating rewards could include two prizes available as a reward, an intermediate prize and a top prize. The levels of these could be debated, we suggest as a starting point £50,000 and £100,000 as these have been shown to be attractive levels in PLS schemes in the US[59].

Prizes could be paid for by taking a small proportion of the amount saved by each enrolled saver, or from the interest accrued, therefore meaning no additional cost to the government or employer. The money accrued could enter a central fund, which would then pay out an allotted number of prizes each month or year.

The amounts that individuals must reach before becoming eligible for rewards could be piloted. Below we have set the limits at £300, £750 and £1,000 as an illustration.

An auto-enrolment rainy day savings scheme: A StepChange Debt Charity model.

1. Make pension saving accessible by either:

a. Creating an accessible precautionary saving 'jar' within a pension pot which could only contain a maximum of £1,000 and needs to be re-filled once used; or,

b. Diverting a proportion of contributions currently intended for pensions into a linked savings account, up to £1,000.

[xii] Used here to mean in a manner that is not a broadly rational balance of short term need (e.g. an unplanned expense that can't be covered by income) and long term benefit of retaining savings.

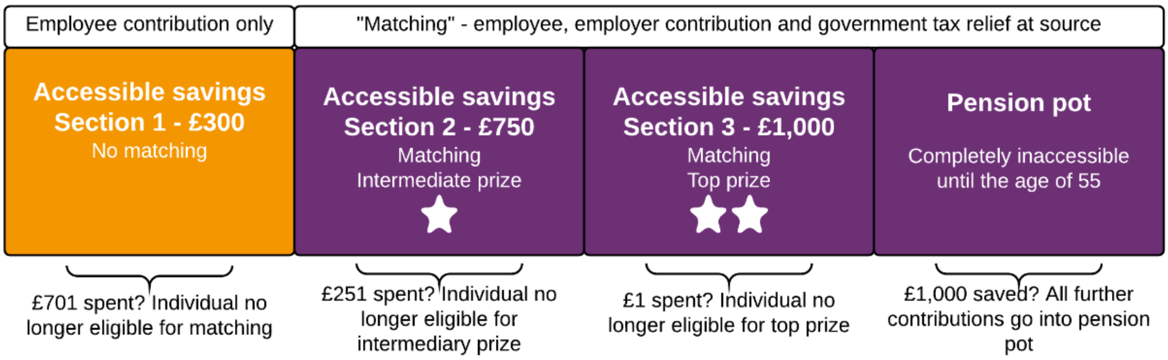
2. A default (for example, 50%) would be in place to specify the proportion of an individual's pension contribution that goes to accessible saving. Individuals could easily override this default.

3. A matching element of employer contribution and relief at source would be attached to the money going to accessible saving. It would be proportional to the proportion of the employee contribution going to accessible saving but not be available until the individual has saved at least £300[xiii].

4. Once the amount saved reaches two further thresholds the saver would become eligible for annual 'prizes', an intermediate prize (at £750 of savings) and a top prize (at £1,000 of savings). These incentives would then operate in reverse order, with individuals becoming ineligible for rewards as they spent money. They would need to refill their savings jar to relevant thresholds to become eligible once more.

5. Once somebody has reached the £1,000 threshold of the jar or linked saving account, all their deductions would automatically divert back into their pension.

Illustration



This adapted system would require legislative and administrative changes to make an element of pensions saving accessible prior to 55, or to make auto-enrolment deductions not go into a pension and enable NEST to provide non-pension saving. However, there are existing systems that could be used to at least pilot these changes and reduce longer-term administrative costs.

Accessible precautionary saving 'jar' within a pension pot: the majority of pension products and schemes, including NEST, offer a number of funds, including a cash fund[60]. One option would be to use these cash funds (or additional cash funds specifically for the purpose) as accessible savings jars. Legal changes could make these cash funds accessible.

[xiii] i.e. if the employer contribution is overall £100, and the employee contribution is £100, of which £30 goes into the saving jar or account – then £30 of the employer contribution will also go into the saving jar or account as well as the relevant relief at source.

Linked savings account: In some ways existing payroll saving schemes are an example of how linked accounts could be run. Employer-based, payroll-linked schemes appear to be increasing in availability in recent years, including schemes we have discussed above where deductions are sent to a corporate ISA. A poll of employers by Chartered Institute of Payroll Professionals found just over half of respondents offered a savings scheme[61]. In an estimated 70% of schemes the money saved went into a Credit Union account[62].

Such accounts could serve as the basis for an accessible rainy day savings fund linked to auto-enrolment, and set up to receive contributions deducted from payroll. At the moment, individuals are not auto-enrolled into a payroll saving schemes and matching is not statutory. This means that they do not encourage saving sufficiently. In the US, even for those with access to an employer-sponsored plan, almost a quarter fail to join, and among those who do join, many save too little[63].

Case study

We can use a case study to illustrate how the proposed system would work.

- Employee A becomes auto-enrolled (after 1 October 2017)
    - Net Annual Income £25,000
    - 2.4% contribution - £50 per month
    - Auto-enrolment includes employer contribution at 2% on whole salary - £42 per month
    - Government tax relief at source (0.6%) - £13 per month
    - **Total monthly contribution - £105**
- Employee A allows the default to split his contributions evenly between pension pot and accessible precautionary pension jar or linked saving account.
    - Therefore, initially:
        - Pension pot – 50% of employee contribution (£25), all of employer contribution (£42) and relief at source (£13) = £80
        - **Accessible pension jar or linked saving account – 50% of employee contribution (£25)**
- Employee A fills up Section 1 of saving jar
    - Takes 12 months of saving
- 50% of employer contribution (£25) and 50% of relief at source (£6.5) divert to accessible pension jar or linked saving account
    - Therefore:
        - Pension pot - 50% of employee contribution (£25), 50% of employer contribution (£25) and 50% of relief at source (£6.5) = £56.5

        - **Accessible pension jar or linked saving account - 50% of employee contribution (£25), 50% of employer contribution (£25) and 50% of relief at source (£6.5) = £56.5**
- Employee A fills up sections 2 and 3 of accessible pension jar or linked saving account
    - Section 2: 8 months – now eligible for intermediate prize
    - Section 3: a further 4 months – now eligible for top prize
- **Total saving period: 2 years**
- All contributions now revert to pension pot

Impact on retirement income

One of the main concerns about these proposed changes will be the impact they might have on retirement income. However, we can calculate this effect and the impact of introducing an accessible precautionary pension jar or linked saving account does not outweigh the value of accessible savings. Indeed, the impact is likely to be relatively minor when shown as annuity income.

Using the above case study we can model the impact on a pension pot as a result of these changes. On the basis that:

- An individual starts to contribute at age 25
- The contributions are as above until the individual reaches age 45 when his income rises to £35,000 – at this point his contribution rises to 6% and his employer's remains at 3%
    - This lowers the accrual periods as follows (still assuming even split):
        - Section 1 now 4 months
        - Section 2 now 3 months
        - Section 3 now 2 months
        - **Total accrual time now 9 months**
- They use the accrued savings twice before retiring at 67 – once before 45 and once after 45 – therefore has to fill up the saving jar three times, twice at 24 months, once at nine months – but the nine month accrual reverts to pension at age 67[xiv]

[xiv] Further assumptions: 1) Retiring at 67, 2) Not taking tax free lump sum, 3) Single, 4) No needed to provide income for others after death, 5) No guarantee period, 6) No increase year-on-year.

Existing system	Proposed system

• 20 years x total monthly contribution (240 months) of £105
  ○ **£25,200**
• 22 years x £305 (264 months)
  ○ **£80,520**
 	
Total accrued by 67 = £105,720
 	
Estimated annuity income (monthly) = £550[xv]
	• 194 months x £105
	• 24 months x £80
	• 24 months x £56.5
	  ○ **£22,968**
	• 22 years x £305 (264 months)
	  ○ **£80,520**
	
	Total accrued by 67 = £103,488
	
	Estimated annuity income (monthly) = £539

Based on current life expectancy the individual in the above table is likely to live for a further 16 years. On the basis of the monthly contribution difference they are likely to receive £2,112 less during the whole of their retirement than with the existing system. However, we must subtract from this the additional £2,000 they have spent during their life. Therefore this change overall reduces an individual's lifetime wealth by £112.

If an individual did not have access to the £1,000 during a crisis, such as redundancy, however, they might be forced to turn to credit. In the long term, this can be immensely damaging to their financial health. In just 6 months, a client with a typical range of debts and arrears could face an additional £2,300 debt[64].

Impact on employers and pension funds

It is unlikely this scheme would be overly complicated for employers or pension funds as it would largely be based on the existing auto-enrolment framework. Previous analysis shows any adaptation of this framework is unlikely to result in significant cost increase. A DWP study with employers in 2014, showed they rarely incurred substantial ad hoc costs as a result of implementing automatic enrolment. Most employers reported an average total implementation cost of between £200 and £700[65]. Employees trust their employer to pick a good scheme and manage it for them[66].

2. Encouraging savings for people outside pension auto-enrolment

While we hope the above scheme, or a similar approach, will help millions start saving, there remains the problem it will not help those who are excluded from auto-enrolment due to being unemployed, below the enrolment limits, or self-employed.

[xv] Based on Money Advice Service Annuity Calculator. Not taken into account, fund charges and investment gains

There are ways in which financial services providers could improve their current saving offerings to better appeal to these groups and lower-income families in general. In addition, the government and stakeholders could put in place a longer-term plan to address these issues.

Financial Services Providers

<u>Allowing low/intermittent saving</u>

Recommendation 3: Banks should explore, develop and ultimately pilot savings accounts which allow families to access headline savings rates and offers even if they can only open accounts with a small deposit and only pay in small, irregular amounts.

As we have seen from examples above, accounts which can be opened with a low deposit, that make it possible to make small subsequent deposits intermittently and which do not require a minimum amount to be saved in them are very popular with struggling savers. The problem in the UK is that accounts that carry higher average AERs or bonus features are not available to lower-income consumers, and those who are limited to small irregular deposits. This applies to both current and savings accounts. For example, if we look at the top seven current accounts identified by a leading online consumer website we can see all of them require either a high monthly deposit level or a minimum amount saved, or both, to qualify for the headline rate of AER.

Figure 10

	IN-CREDIT INTEREST (AER)	AFTER BASIC TAX	MAX INTEREST /YR (1)	MIN MONTHLY PAY-IN	HOW MANY CAN YOU HAVE?
[redacted]	3% if you've £3,000-£20,000	2.4%	£450 (after fee)	£500	2 (2nd must be joint)
[redacted]	4% if you've £4,000-£5,000	3.2%	£157	£1,500	2 (2nd must be joint)
[redacted]	3% if you've £3,000-£5,000	2.4%	£118	£1,000	3
[redacted]	5% on up to £2,500 for 1yr (2)	4%	£98 (yr1)	£1,000	2 (2nd must be joint)
[redacted]	5% on up to £2,000	4%	£78	£500	2 (2nd must be joint)
[redacted]	3% on up to £3,000	2.4%	£71	£750	2
[redacted]	£5/mth (3)	£5/mth	£60	£750	2 (2nd must be joint)

(1) After basic tax if you always held the max balance+. (2) 1% after. (3) Paid regardless of balance, as long as you stay in credit. The £5 is classed as after having paid basic rate tax. So higher taxpayers will lose some of the gain.

Source: Money Saving Expert, accessed July 10 2015

This is a subject consumer groups have been pondering for a while. We know also that financial service providers are currently engaged in internal discussions about how to offer lower-income families a better savings deal. The FCA as well is engaged with this agenda through its work on access to financial products. The challenge is to see how all these groups can co-ordinate to the advantage of struggling families.

One potential way forward would be for providers to pilot saving accounts offering a good deal which individuals can access without having to make significant initial deposits and which allow them to save lower amounts on an intermittent basis. Alongside proven incentives like prizes, providers may want to explore what other offers would particularly appeal to lower-income consumers. For example, they may consider schemes similar to that piloted by Toynbee Hall where savers were given free home insurance if they continued to make deposits[67]. The third sector involvement would be twofold. Firstly to help banks understand the potential target audience. Secondly, to help banks reach these groups in an appropriate way. The FCA may be able to help the process through its 'Project Innovate', a hub designed to help firms introduce innovative financial products and services to the market.

Better use of prize-linked accounts

Recommendation 4: Financial services providers should explore the use of prize-linked savings accounts which appeal to lower-income consumers.

Prize-linked saving has a demonstrated value in encouraging saving among groups that may currently be less likely to engage with financial services. More financial services providers should therefore explore the use of these savings products to encourage lower-income and less-engaged families to save.

Although some financial services providers do have accounts with a prize-linked element, these do not currently appear suitable for lower income consumers. This is partly because they require larger deposits, and partly because they do not make best use of incentives that are known to be effective among those on a lower income. As we have seen above, one particular way of offering a prize-link is to offer an opportunity to win a prize on the occasion of each deposit, rather than over a set time period[68]. Financial services providers may want to explore this option. This would be one way they would differ from Premium Bonds. These products could be further differentiated by having no minimum deposit and being interest accruing.

Government

If the government is serious about generating a savings culture in the UK, and building it will be important for them to help groups without the means to save for themselves.

Reaching the unemployed / those moving in and out of work

Recommendation 5: Government should build a saving element into the welfare system via work allowances and income thresholds in Universal Credit and tax credits.

In addition to the recommendations above, a policy solution is needed to help families who are unlikely to benefit significantly from an auto-enrolment system linked to pensions due to members being below the enrolment thresholds or long-term unemployed.

These families are unlikely to have any level of savings but, if anything, are more likely to need savings as they are especially vulnerable to the impact of an unexpected bill[xvi]. Almost one-third (30.8%) of people coming to StepChange Debt Charity for help with their problem debts are unemployed. A further 18.1% are employed only part-time[69]. Although a £1,000 saving pot will not act as long-term

[xvi] For example, only 26% of families where the HRP is unemployed have accessible cash savings of £1,000 (see Appendix 2).

replacement income for these families, and they will still require the income-replacement of welfare, it will help cushion the immediate impact of an income shock, making it less likely families will have to turn to credit.

For the government, an additional benefit of this is that it will make families more resilient when faced with bumps in the road, which will have a positive impact on work trajectories. For those in work, an accessible cash savings pot will allow them to overcome financial difficulties that might in other circumstances lead to having to leave work, for example a car breaking down. For those seeking work, a savings cushion would provide liquid capital to engage in job seeking, allowing individuals to re-join the workforce more swiftly.

To aid this, the government may want to consider factoring a saving element into the welfare system. One way of doing this might be via Universal Credit, considering the government is seeking to migrate all claimants onto this benefit in the years ahead

There is currently a 'work allowance' within Universal Credit. This is the amount claimants can earn through work per year before a 65% 'taper' is applied to earnings. Changes to the level of this work allowance were announced in the Budget on the 8th July 2015. It will be reduced to £4,764 for those without housing costs, £2,304 for those with housing costs and removed altogether for non-disabled claimants without children[70].

There is a similar allowance within the working tax credit system (known as an 'income threshold'). The July 2015 Budget reduced this from £6,420 to £3,850 from April 2016[71].

In order to incentivise savings, the level of the work allowance and working tax credit income threshold could be increased as long as claimants save the additional allowance. So, using the example of Universal Credit, for claimants with housing costs who want to save but are struggling, the allowance could be raised from £2,304 to £3,304 as long as the difference is saved. A similar uprating of the threshold could be applied for working tax credits.

This could be particularly fruitful avenue for the government to explore because alongside its welfare function, it would act to incentivise people to work more hours.

<u>Improving the chances of the next generation</u>

Recommendation 6: Government should expand current trials of credit union accounts for primary pupils, linked to financial education, into secondary schools.

If the government is serious about developing a long-term saving culture in the UK it is important to ensure people develop positive savings habits as early in life as possible. In *The Debt Trap*, StepChange Debt Charity and the Children's Society recommended that the government should establish a trial of credit union accounts for secondary school pupils, linked to financial education in schools, to establish the effectiveness of this approach in promoting savings to young people[72].

The government has taken forward this recommendation, funding a pilot programme to help children develop good financial habits at a young age by setting up savings clubs in primary schools in partnership with credit unions. The 'LifeSavers' project, which is led by the Archbishop of Canterbury's task group on responsible credit and savings, will seek to equip children with good financial habits by educating them about the benefits of saving at an early age[73]. It will also introduce children to credit unions, which play a key role in providing financial services to more than a million customers across Britain.

We believe it would be beneficial to extend this pilot to secondary schools in order to ensure as many children as possible have developed positive financial habits before moving into the world of work. Local authorities in both Glasgow and the London Borough of Haringey are already providing secondary school children with 'seed money' in a credit union account to get them saving. The government may wish to draw lessons from their experience, as well as that of the 'LifeSavers' project, in order to drive forward this welcome agenda.

Ensuring recovery from problem debt

Recommendation 7: Enhance the current proposal to include a savings element in the budgets of people receiving debt advice to resolve financial difficulties by: a) formalising the saving from a provision in the individual's budget to a deposit in an accessible savings vehicle; b) ensuring creditors and essential services providers are fully engaged with the process; and c) the FCA explicitly acknowledging the benefits of saving in a client budget, as long as the consequences are fully explained to clients in terms of taking longer to pay down debt.

Across the UK millions of families are struggling with problem debt. Many of these will seek to address their financial difficulties by accessing a debt advice solution, such as a Debt Management Plan (DMP). A DMP is a non-statutory solution in which people repay their debts at an affordable rate. It necessitates rigorous budgeting and often results in several years of a family cutting back expenditure in order to honour their commitments.

While the budgets that debt advice agencies put together for clients already typically contain a small amount for contingencies and emergencies, more can be done to build resilience for people who are coping with problem debt.

The Money Advice Service is currently engaged on a project to design a 'Standard Financial Statement'. This contains universal budgeting guidelines that would be used by all debt advice providers and others. These guidelines will specify that, where possible, individuals who complete a budgeting session with a debt advice provider should be able to set aside a certain amount each month as precautionary saving. An individual would only be able to put money aside for saving if all essential bills had been paid, but they can put this money aside before making debt repayments. Individuals who enter a DMP as a debt solution would be able to save in this fashion[74].

This is a valuable project, which StepChange Debt Charity supports. However, there are some ways in which its effectiveness could be improved. For example, there could be more consideration over how individuals using the SFS save, by encouraging them to products like the ones we are calling on providers to pilot. More could be done as well by government and creditors to enhance the project. Either voluntarily (for example, through the Lending Code) or statutorily, creditors (including public sector creditors) could be required to accept reasonable budgets which contain a savings element. The FCA should give this initiative their backing, recognizing the benefits of wider access to saving, and removing a perceived barrier to creditor acceptance. Of course, the benefits and consequences of saving will need to be spelt out for clients.

Conclusion

The new research in this report has confirmed that too few families in the UK have a ‘rainy day’ saving fund. In particular, the situation is dire for families with a low income, living in rented accommodation or with young dependent children.

These struggling families need savings, primarily to help them avoid falling into debt. Therefore, the economic and behavioural barriers that prevent them saving need to be overcome.

We have illustrated initiatives used in both the UK and abroad that have had success getting families saving. To meet the saving challenge the lessons these teach must be learn and applied.

The UK is lucky that we already have a successful auto-enrolment system in place for pensions with a matching element that could be adapted to help families access a limited amount of precautionary savings. This report has suggested a way in which this could be done, and we are keen to discuss this with interested parties in order to take it forward.

However, this alone is not enough and financial services providers and government need to do more to help more vulnerable families build resilience through rainy day funds. Recommendations from this report should give them an idea of how to do this. It is critical for families and the economic health of the country that everybody has the ability to put a little aside, enough to provide a fall back against income and expenditure shocks. Working together we can achieve our goal.

There is a long way to go, but a path is visible. Let the journey begin now.

Appendix 1[xvii]

Partitioning the population with classification trees – See Research Sections 1 and 2 of report

Select Statistical Services partitioned the population into groups defined by socio-economic factors by creating classification trees of groups made up of several of these factors. The aim of a classification tree is to partition the data in such a way as to maximise the separation between the groups according to a given outcome. Select fitted two classification trees: one based upon whether the household has any cash savings as the outcome, and the other based upon whether the household has at least £1000 cash savings as the outcome.

A classification tree is generated by a recursive binary partitioning of the data. A binary split is defined using one of the candidate variables (which in this instance are the socio-economic factors). If the variable is continuous then the split is defined by a threshold, with all cases greater than the threshold going into one class and the rest going in the other class. If the variable is categorical then the split is defined by choosing a subset of categories, with all cases in those categories going into one class and the rest going in the other class.

Various algorithms are available for generating trees, each using different criteria for choosing the optimal split at any given stage in the tree. Select used an algorithm that views the tree as a probability model and measures the value of a split in terms of the likelihood of observing the data given the model. Introducing an additional split will increase the likelihood, and the split that results in the greatest increase in the likelihood is the optimal choice. A stopping rule is applied to determine when the increase in likelihood is insufficient to warrant a split and therefore controls the final number of groups (known as "leaves") defined by the tree.

The WAS data includes sample weights that are used to account for the sampling design and non-response in the survey in order to ensure that the data are representative of households in Great Britain. Select applied the sample weights throughout the fitting of classification trees, so that choices of splits were based on unbiased population estimates of the outcomes (proportions of households with any cash savings or at least £1000 cash savings).

Estimating the distribution of attitudes in the population groups – See Research Section 2 of report

For the second part of the analysis Select focussed on the partition defined by the tree based on the outcome of whether the household has at least £1000 savings. For

[xvii] http://www.stepchange.org/Portals/0/documents/Reports/SocioEconomicGroupsAndSaving.pdf

each group Select estimated the distribution of responses to the four attitudinal questions described in Research Section 2 above.

Select applied the sample weights in the analysis so that the resulting distributions are unbiased estimates for the population of households Great Britain

Appendix 2[xviii]

Households with at least £1,000 in cash saving: other socio-economic categories

Nssec of HRP or partner	Savings ≥ £1000
Never worked/long term unemployed	83.7%
Managerial & prof. occupations	71.8%
Intervediate occupations	57.3%
Routine & manual occupations	34.4%
Not classified	41.8%

Employment Status of HRP or partner	Savings ≥ £1000
Employee	72.1%
Self-employed	77.1%
Unemployed	26.0%
Student	40.9%
Looking after family home	27.3%
Sick or disabled	26.6%
Retired	82.8%
Other	56.1%

[xviii] Some of the results in the below tables may seem counter-intuitive (for example, the high level of saving among never worked/long term unemployed respondents). However, this is a result of these categories of respondents having a low sample size, and including respondents who may fall outside our expectations, for example long term unemployed including those who have inherited money.

De facto marital status of HRP/partner	Savings ≥ £1000
Married	79.3%
Cohabiting	65.2%
Single	52.7%
Widowed	78.1%
Divorced	55.7%
Separated	47.5%
Same sex couple	87.8%
Civil Partner	78.6%
Former Separated Civil Partner	NA

HRP or partner has longstanding illness, disability or infirmity	Savings ≥ £1000
No	72.7%
Yes	67.8%

Household type	Savings ≥ £1000
Single person over SPA	78.0%
Single person below SPA	90.6%
Couple over SPA	79.9%
Couple below SPA	87.1%
Couple, one over one below SPA	65.5%
Couple and dependent children	83.0%
Couple and non-dependent children only	27.1%
Lone parent and dependent children	62.8%
Lone parent and non-dependent children only	75.5%
More than 1 family, other household types	53.0%

Number of dependent children in household	Savings ≥ £1000
0	75.9%
1	61.0%
2	59.1%
3	48.8%
4	34.8%
5 or more	29.1%

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