Citi Foundation

WHAT IS COMMITMENT SAVINGS?

Getting to Know the Product

NOTE 1. Inclusive Commitment Savings in Latin America and the Caribbean

PROSAVINGS
Accounts that Count

Notes from the Series Inclusive Commitment Savings in Latin America and the Caribbean:

NOTE 1. What is Commitment Savings? Getting to Know the Product
NOTE 2. Commitment Savings. Exploring the Market
NOTE 3. Keys to Success for Commitment Savings. The Best Ingredients
NOTE 4. Expanding Commitment Savings. A Menu of Challenges

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ABSTRACT

The following article is part of a series of four research notes on commitment savings, commissioned under the ProSavings Program framework.

NOTE 1
The first note addresses the concept of commitment savings as an adequate product for the low-income population.

NOTE 2
The second introduces the commitment savings supply in Latin America and the Caribbean, following a desk review of products offered by 1,350 institutions in 26 countries.

NOTE 3
The third note presents key elements to guide the design and implementation of commitment savings products, drawn from in-depth interviews with 14 financial entities in Colombia, Jamaica, Mexico, Panama, and Venezuela.

NOTE 4
Finally, the fourth note analyzes the challenges of offering commitment savings products based on the survey responses of 73 entities in the region with such products.

A financial system that the majority of the population has access to is important for development and reducing inequality.[1] The past few years have witnessed the establishment of policies whose objective is to prompt the lowest income segments to use products and services offered by financial institutions. A particular emphasis has been put into policies that facilitate access to the financial system through credit. Low-income people, like the rest of the population, need diverse products and services to best manage their finances. Therefore in the last few years, several initiatives have been established to further financial inclusion through savings, thereby helping low-income people improve their money management.

Efforts to measure financial inclusion are still very recent; therefore, in order to obtain accurate data, it is necessary improve the quantity and quality of information regarding access to financial services. Despite these shortcomings, studies and surveys demonstrate that the majority of countries in Latin America and the Caribbean have low levels of banking penetration in comparison to other regions. According to Global Findex data, only 10% of adults in Latin America and the Caribbean save at a formal financial institution[2].

It is common to attribute this type of data to a lack of savings capacity within the low-income population and to a lack of interest from financial institutions in serving this segment. Alternatively, this article suggests that what hinders savings mobilization among this segment is the lack of relevant products that specifically respond to the needs of the low-income population. Within this context, we introduce commitment savings as a product design whose features can help the low-income population save periodically and in small quantities, allowing them to build savings over time that can be destined for several purposes.

1. United Nations (2006). ***Building inclusive financial sectors for development.*** New York.
2. Demirguc-Kunt, A., L. Klapper and D. Randall (2012). "Global Findex Database. Financial inclusion in Latin America and the Caribbean. Findex Notes. World Bank, Washington, DC.

LOW-INCOME PEOPLE DO SAVE

Often the lack of formal savings among the low-income population is attributed to their lack of savings culture, of discipline, or of income. This view is particularly predominant among financial entities. Early in 2013, a survey was conducted under the ProSavings Program framework, collecting responses from 72 financial entities offering commitment savings products in Latin America and the Caribbean. Of these entities, 87% reported that the main obstacle preventing low-income people from achieving their goals was either: a lack of savings culture (51%), or a lack of savings capacity (36%).

However, this view clashes with abundant studies and evidence that demonstrate that low-income people do save.[3] In fact, they usually diversify their savings methods by using instruments with different levels of liquidity that vary from cash to jewelry, cattle, or land. Moreover, participation in informal savings clubs is a widely spread practice throughout Latin America and the Caribbean. The very success of microfinance also demonstrates that low-income people are perfectly capable of saving part of their income periodically to repay their loans.

Impulsive consumption and a lack of savings culture are features that are not solely exclusive to the low-income population. Without question, more and better financial education initiatives are necessary to promote the practice of savings. Nonetheless, client education alone will hardly lead to an increase in savings if there is not a savings product offer that suits the specific needs of the low-income population. When there are attractive and accessible products in the market, the low-income population tends to demonstrate a greater interest, capacity, and willingness to save through formal institutions.[4]

Although circumstances vary when referring to the low-income or poor population (given their wide spectrum of saving capabilities), generally, having a low level of income does not preclude savings. In fact, establishing savings mechanisms becomes particularly important in situations of vulnerability and fickle income, in order to plan future expenses and fulfill different responsibilities. Financial entities can satisfy a large part of low-income people's demand for savings; as long as they develop innovative products that help build savings.

FINANCIAL ENTITIES AND THEIR GROWING INTEREST IN THE LOW-INCOME POPULATION

From a supply-side standpoint, it is usual to cite the costs associated with operating a savings account and the minimum deposit requirements as the main obstacles that hinder formal savings among the low-income population. However, it is increasingly common to find entities that offer savings products free of fees or with minimum deposit requirements. In the same survey mentioned above, 92% of the entities reported charging no fees for their commitment savings accounts, and 63% of the entities

3. Collins, D., J. Murdoch, S. Rutherford and R. Orlanda (2009). Portfolios of the Poor: How the World's Poor Live on $2 a Day, Princeton: Princeton University Press.
4. In Brazil, 64% of adults lacking a bank account at any formal financial institution show interest in opening one. Kumar, A. (2005). Access to Financial Services in Brazil. Washington, D.C.: World Bank.

required a minimum opening amount lower than US$10. Likewise, 92% of the entities were interested in developing new commitment savings products or marketing strategies to mobilize savings among the low-income segment.

In the region, several countries have promoted legislation aimed at facilitating the opening of simplified savings accounts and free accounts for low-income people. These initiatives have led to an increase in the opening of savings accounts among this segment; although several entities report that an elevated percentage of these accounts have low to no activity. Therefore, besides being accessible these products must also be relevant, so that the clients can trust the institution and reduce their dependency on informal savings systems. It is futile to offer a product free of commissions if its design and marketing are not planned to satisfy the particular needs of this segment.

WHY DO SUPPLY AND DEMAND FAIL TO MEET?

Currently most financial institutions have not been able to offer savings products that are convenient and interesting enough to make people give up their informal savings mechanisms. The methodological, organizational, and design innovations introduced by financial institutions to offer credit to the low-income population have not been introduced with the same intensity in the case of savings. The savings product supply tends to be scarce, lacks variety, and is rarely specifically targeted to the low-income population. Most entities offer fixed-term deposits and transactional accounts, but not many offer savings products specifically designed to build savings among low-income households.

"When there are attractive and accessible products in the market, the low-income population tends to demonstrate a greater interest, capacity, and willingness to save through formal institutions"

Fixed-term deposits are usually oriented towards households with medium to high income levels that have accumulated some savings and are looking to invest mainly to generate an income in the form of accrued interest. Strictly speaking, fixed-term deposits are more an investment rather than savings instrument and therefore, tend to be more focused on generating profits than on facilitating the accumulation of savings. On the other hand, though transactional accounts may be very useful in helping the the low-income population manage their payments and income; they do not usually incorporate designs or incentives to help clients save in order to cover future expenses (education, household, acquiring assets) or to protect themselves against possible emergencies.

WHAT IS COMMITMENT SAVINGS?

Commitment savings products, also known as planned savings or contractual savings, are known for incorporating specific mechanisms that help clients save small amounts periodically which, over time, allow clients to build savings that can be used for different purposes. With commitment savings products, the client usually commits to making periodic deposits during a specific time frame to accumulate a determined amount of savings. There are several designs for commitment savings products, which make it difficult to establish a rigid definition that draws a clear line between what commitment savings is and is not. In any case, it is possible to identify a series of attributes that are characteristic of commitment savings products:

"The savings product supply tends to be scarce, lacks variety, and is rarely specifically targeted to the low-income population."

Commitment savings products' attributes

RECURRING SAVINGS

The concept of recurring savings is perhaps the feature that best defines commitment savings products. The client commits to deposit the same amount on a daily, weekly, or monthly basis during a particular period. The idea of making an explicit commitment to save based on a predefined plan is the essential element of a commitment savings product.

INTEREST RATE

Its profitability tends to be greater than that of transactional accounts but less than fixed-term deposits. With commitment savings, the client looks for a product whose features will help him or her to reach a savings goal. Interest rate is usually a secondary factor. Generally, low-income populations' savings tends to be insensitive to interest.[5]

TIME FRAME

The length within the savings time frame is set as a function of the savings goal. Savings plans ranging from 3 to 12 months tend to be most common among the low-income population. However, depending on the savings goal they can also range from 24 to even 60 months.

LIQUIDITY

Commitment savings products tend to incorporate a feature that adds a certain level of illiquidity. Low liquidity can help to discipline savings and reduce self-control issues that often hinder the ability to fulfill a savings plan. As demonstrated by some studies, the lack of liquidity in a commitment savings product can represent an attractive feature for clients.[6] However, an excess of illiquidity can also discourage the adoption of a product. A well designed savings product tends to incorporate features that hinder an impulsive withdrawal of accumulated savings but also allow access to these funds in case of need.

SAVINGS GOAL

Often commitment savings products are designed and commercialized to enable the fulfillment of specific savings goals linked to events or future concrete expenses (school savings, Christmas savings, household savings, etc.). Although it is common to structure commitment savings products by associating these to specific future expenses, it is also common to find products without concrete objectives. The latter provides a greater level of flexibility so that each client can design the features of his/her savings plan in relation to a savings goal.

INCENTIVES

In order to promote savings, it is common for entities to offer incentives to clients that meet their savings plan. These incentives can be offered as sweepstakes, gifts, or bonuses on interest rates.

5. Assertion based on academic publications and validated through field observations. For instance: Reinhart, Carmen and Ostry, Jonathan. (1995). "El ahorro y la tasa de interés real en los países en desarrollo," ***Finanzas y Desarrollo***, Vol. 32, No. 4
6. For instance: Ashraf, N., D. Karlan, and W. Yin. (2006). "Tying Odysseus to the mast: Evidence from a commitment savings product in the Philippines," ***Quarterly Journal of Economics***, 121(2), 635–672 and Beshears, J. J. Choi, D. Laibson, B. Madrian and J. Sakong (2011). "Self-control and liquidity: How to design a commitment contract," Working Paper.

Perhaps it is useful to think of commitment savings not as a specific product but rather as a group of incentives and disincentives that, when packaged correctly, can help clients save small amounts periodically; which, over time, can build savings that can be used for several purposes.

TO SAVE OR TO BORROW?

A given need can be fulfilled both through savings and credit products or strategies. As notably illustrated by Stuart Rutherford in his book, ***The Poor and Their Money***, credit can be regarded as "descending savings" . Credit can help obtain money that can allow one to finance an expense today, in exchange for saving small amounts in the future destined to repay the debt acquired. Alternatively, one can begin saving today and continue accumulating small amounts along a period of time, until gathering an amount that can be used to finance a future expense ("ascending savings").

The lack of savings products designed to help the low-income population build savings causes many of them to turn to credit products ("descending savings") to cover needs that could be better served at a lesser cost, by a savings product ("ascending"). Most low-income households must finance expenses such as weddings, school fees, or household improvements. Becoming indebted or even over indebted at high interest rates in order to finance these types of expenses that do not generate an immediate return is costly, but it is often the only alternative.

Children's education systematically appears in every study as an important motivation to save and/or become indebted. School fees, which in many countries are paid at the beginning of the school year, can represent a considerable expense for families with several school-age children. Without adequate savings products to help families plan and periodically save for expenses such as school fees, it is common for families to become indebted to cover these expenses. In Haiti for instance, according to Global Findex data stemming from surveys conducted in 2011, the bottom 40% of the population according to income level allocates 21% of its loans to the payment of school fees. For many families, a good savings product could be a much more attractive option than becoming indebted with interest rates higher than 50% to be able to afford their children's education.[7]

WHAT CAN WE LEARN FROM INFORMAL SAVINGS?

As stated before, low-income people tend to save more than what is often assumed. When facing high levels of uncertainty, it is essential to manage small incomes in order to meet commitments to future expenses or to withstand emergencies. These circumstances can account for the diverse and sophisticated informal savings mechanisms currently in existence. Most informal savings mechanisms offer a savings discipline without foregoing certain liquidity in case of need. Saving in jewelry or gold allows one to accumulate value such that in the case of an emergency, these can be pawned to obtain liquidity. Likewise, investing in animals allows

7. The World Bank Group. (2012). ***Financial Inclusion Data.*** Available online.

one to save in a way that prevents impulsive expenses, but also offers the possibility to sell and obtain cash in case of an emergency. Savings groups also provide discipline to save periodically, without withdrawing or giving up certain flexibility for cases of need; which is facilitated by the existing familiarity among group members.

The combination of liquidity and illiquidity of informal mechanisms is highly attractive to families facing a lot of uncertainty but also those who need mechanisms to help them commit to saving on a medium to long-term basis. This balance between liquidity and discipline is a basic element of informal savings mechanisms that commitment savings products ought to incorporate to attract the low-income population.

Another feature of informal savings is the tendency to use different tools to achieve each savings objective. Despite the convertibility of money, low-income people tend to use several informal savings tools simultaneously. A person can save jewelry for long-term purposes such as a daughter's wedding, but can also create a savings group to pay for education expenses, and keep cash under the mattress to use in case of emergencies.[8] This idea of mentally assigning a specific destination to each

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8. Mas, I. and P. Mukherjee (2013). "Searching for Metaphors of Household Financial Management". MicroSave.

savings tool seems to help many people to better plan their expenses and their savings. Incorporating designs that help to easily compartmentalize different savings objectives can make commitment savings products more attractive for the low-income population. In some countries over the past few years, the idea of developing a savings account that can help low-income people to better plan their personal finances by incorporating mechanisms that facilitate the compartmentalization of objectives that is characteristic of informal savings, has income increasingly popular. In England for instance, "Jam Jar Accounts" (thus named because many people tend to save in empty jam jars according to their savings objectives) have become increasingly common.[9]

PSYCHOLOGICAL FACTORS THAT HINDER SAVINGS

Human beings do not make decisions in a perfectly rational manner. There are psychological factors that significantly influence our behavior. Behavioral economics incorporates elements of psychology mainly drawn from experimental studies of circumstances in which certain factors can aid or hinder savings decisions. In the field of microfinance, the ***Abdul Latif Jameel Poverty Action Lab***, a research center affiliated with the Economics Department of the Massachusetts Institute of Technology, has been particularly active in the use of randomized impact evaluations to study the savings behavior of low-income populations. The results of this and other research increase our knowledge on psychological factors that hinder savings. Financial entities can benefit from this knowledge by incorporating some of the findings into their commitment savings product design.

"Human beings do not make decisions in a perfectly rational manner. There are psychological factors that significantly influence our behavior."

9. Social Finance (2011). "A new approach to banking. Extending the use of Jam Jar Accounts in the UK".

Psychological factors that hinder savings

- **WE OVERVALUE THE PRESENT**

Our long-term preferences are in permanent conflict with our behavior in the short-term. In the long-term we wish to eat healthier, but in the short-term it is more tempting to eat sweets. This gap between plans and actions is also important for our long-term savings decisions. We want to save, just not today. It is easier to commit to save in the future than to start saving now. Commitment savings products can overcome this obstacle with a product design that allows one to commit (now) to accumulating savings (in the future), and that is linked to the flow of household income and expenses. In much the same way, positive reinforcements can be introduced to offset the effort of saving in the now. Small incentives can reinforce and offset the effort associated with making each deposit, rather than tying all the benefits of saving to the final fulfillment of the savings plan. These types of reinforcements can sometimes be symbolic, such as receiving a text message via mobile phone informing the clients of their savings balance and reminding them that they are close to meeting their savings goal.

- **WE SUCCUMB EASILY TO TEMPTATIONS**

When it comes to saving, we have evident self-control issues. As mentioned before, restricting the access to savings can promote self-control and facilitate the discipline of saving. Mechanisms that slightly restrict the liquidity of the product can help prevent impulsive withdrawals. Establishing deadlines for deposits, limiting the number of withdrawals, restricting partial withdrawals, or sending reminders are all features that can help a client fulfill a savings plan.

- **WE GRAVITATE TOWARDS INACTION WHEN WE HAVE MANY ALTERNATIVES**

Products ought to be easy to understand, use, and must reduce the process of deliberation. For instance, discounts that are periodic and automatic - such that it becomes unnecessary to decide in each given moment how much and how to save - can help reduce options and facilitate decision-making. Automation helps savings happen unconsciously.

- **WE TREAT MONEY AS IF IT WERE NOT CONVERTIBLE**

We tend to compartmentalize and look for simple rules that allow us to mentally allocate our money to each of our savings goals (rent, groceries, school expenses, etc.). Establishing mechanisms that help the client save easily through one or several products for different savings objectives can help the client plan these goals better. Defining precise objectives that are tangible and within a reasonable time frame can all be particularly motivating. Something as simple as naming accounts according to the use that the savings will be given can help link savings to specific objectives and thus, enable them.

Due to the progress in the field of behavioral economics, we know more about the various psychological factors that hinder savings, and that ought to be considered when designing a commitment savings product. Amongst these are the following:

Ultimately, the goal is to help people achieve what they desire by avoiding psychological factors that often hinder the practice of savings. Financial entities can promote savings by incorporating into their product design mechanisms that can help mitigate these factors.

FINAL CONSIDERATIONS

When it comes to commitment savings, product design is essential. Integrating the psychological perspective, the findings on behavioral economics, and learning from informal savings mechanisms can help institutions achieve greater success in the design of their products. Designing products that are: simple, easy to understand, easy to use, easy to open, have minimum requirements, are relevant, and incorporate good incentives to encourage deposits and discourage withdrawals, can help promote savings among the low-income population. Evidently, design is not everything. No matter how good a product is, it will not sell on its own. Therefore, it is also necessary to invest in marketing, to take advantage of what we know about informal savings mechanisms, and to have motivated employees that actively sell products and look for new outlets to increase coverage and improve access. Financial entities have a wide margin for introducing innovations in savings products directed to the low-income population. With a good design and an adequate strategy, commitment savings products can play an important role in the mobilization of savings for low-income people.

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