Asset Building Program Working Paper

Unrestricted Savings

Their Role in Household Economic Security and the Case for Policy Action

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Executive Summary

Low savings levels are a significant source of economic insecurity for scores of American families. Households need access to unrestricted funds that can be deployed flexibly to bridge short-term cash-flow gaps and to build their own safety net to prevent small shocks from destabilizing their financial security. The amount of funds required to make a difference will vary; depending on the size of the household and other conditions it could range from $2,000 to $5,000. The presence of savings on a family's balance sheet can reduce the need to borrow, either informally or from high-cost creditors, and preserve financial health over the long term.

Unrestricted savings refers to a range of formal (i.e. held in a depository or investment product) and non-formal (i.e. "under the mattress") savings options that are accessible for an individual's discretionary use. In contrast, more-restricted savings include investments that accumulate over a longer period of time—for instance, retirement savings generated throughout a worker's tenure, or home equity. **A primary purpose for unrestricted savings is to smooth income**—that is, addressing a cash shortfall when expenses exceed household income or ability to pay.

Low- and moderate-income families and those with low savings are challenged to accumulate savings by a variety of factors. Stagnant or low wages leave households with limited discretionary funds available to save for future use. Strict and inconsistent eligibility guidelines for public assistance programs can discourage saving and developing formal attachment to depositories and perpetuate the belief that a modest amount of savings or assets will disqualify one from public assistance. Being "banked" with a depository and being eligible for savings products are also requisite steps to safe saving. Individuals frequenting informal check-cashers, remittance providers, and payday lenders do not have access to savings opportunities at these non-bank establishments, contributing to low saving by these customers.

Moreover, there are **rational arguments to defer saving**. The need to buy basic necessities or repay debt may take precedence in certain scenarios. The structure of today's basic account can discourage low-balance savers. Compared with the often modest amounts contributed to emergency-use savings accounts, fees for maintaining the accounts are high. In a low-interest-rate economy, it may also indeed be rational to encourage someone not to save, if the rate of inflation outpaces the rate of return on a savings account.

Behavioral economics helps explain why individuals under-save, and face barriers to save that are seemingly irrational. This working paper applies four of these principles to the unrestricted saving context; including, temporal discounting, loss aversion, information overload, and awareness of the role of emotion and past experience in human decision-making. This manifests in failing to act on preferences to save and reacting emotionally, if not illogically, when making financial preparedness decisions.

Behaviorally informed policies show promise in leading to behavior change and increasing savings. Policymakers should use a behavioral lens to capture a more complete depiction of the human decision-making processes, to create policies to promote savings, not deplete it.

This analysis confirms that large segments of the population likely have insufficient levels of unrestricted savings, which is troubling because of the correlation between presence of liquid savings and avoidance of costly missteps. Having urgent liquidity needs but no liquid savings to meet the needs can result in households making nontraditional or unproductive economic choices. Households may forgo necessary purchases (i.e. food, medicine, winter clothing), rely on overdraft coverage (i.e. a loan made through their checking account), borrow from their employer or social network, or take on a small-dollar loan.

Unfortunately, **public policy fails to promote unrestricted savings**. Most of the attention given to savings in policy circles has focused on restricted-use savings as a means to build wealth over the long term and promote retirement security. This has created a gap in the policy landscape since shorter-term, more accessible savings are needed by a wide spectrum of the population to reinforce a personal safety net.

There are a number of ways that **public policy could be deployed to more effectively promote unrestricted savings** and significantly enhance the economic security of large segments of the population. First, policy emphasis should be placed on addressing and removing barriers where they can be identified (e.g., reforming asset tests and ChexSystems requirements). Secondly, policy could potentially play a role in improving product options. Thirdly, policies should encourage the use of existing infrastructures where they have proven to be successful in spurring saving. These include a greater promotion of direct deposit and split pay between multiple accounts. Lastly, public sector entities involved in financial inclusion pilots and campaigns should be required to demonstrate results for their investment, and heed encouragement by public leaders to innovate.

In the medical care context, an emergency room visit will cost all involved—patient, provider, and insuring party—much more than affordable, preventive health care. Similarly, the cost of not saving is much higher to families and society than the cost of regular, small deposits to a simple account.

Households use unrestricted, liquid savings to weather economic shocks and to protect themselves from future unfavorable events. With evidence to confirm that the presence of liquid assets decreases the risk of financial hardship, it behooves policymakers to support the ability of households to save regularly in affordable, accessible mechanisms.

Introduction

Managing household finances is no easy matter. It becomes considerably more arduous when families do not have access to savings that can be tapped easily with discretion. Low savings levels are a significant source of economic insecurity for scores of American families. Households need access to unrestricted funds that can be deployed flexibly to bridge short-term cash-flow gaps and to build their own safety net to prevent small shocks from destabilizing their financial security. The amount of funds required to make a difference will vary; depending on the size of the household and other conditions it could range from $2,000 to $5,000. The presence of savings on a family's balance sheet can reduce the need to borrow, either informally or from high-cost creditors, and preserve financial health over the long term.

Public policy largely fails to promote unrestricted savings. Greater attention has been given to crafting policies designed to increase retirement security, homeownership, and postsecondary-education attainment. This has created a gap in the policy landscape since shorter-term, more accessible savings are needed by a wide spectrum of the population. To help families build assets and financial security, policies promoting unrestricted savings must be developed in tandem with those aimed at the long term.

This paper introduces the topic of unrestricted savings, articulates its contribution to household economic security, and describes factors—behavioral and structural—that enable and impede its accumulation. Applying perspectives from the fields of behavioral economics and institutional economics, the paper makes a case for greater exploration of the research and policy frontier for unrestricted savings.

What Are Unrestricted Savings?

In classical economic theory, savings are defined as resources, such as income and assets, that are not consumed but deferred for future use. Unrestricted savings refers to a range of formal (i.e. held in a depository or investment product) and non-formal (i.e. "under the mattress") savings options that are accessible for an individual's discretionary use.[1] These savings tend to be highly liquid; they can be accessed with relative ease. These savings can be used in the short or intermediate term, and in relatively small amounts. Placed typically in accounts with little or no financial penalty for being accessed, they do not benefit from high returns on investment or aggressive interest rates.[2] Moreover, they may make up only a modest amount of money relative to funds held in a tax-advantaged investment account.

In contrast, more-restricted savings include the investment that has accumulated over a longer period of time—for instance, retirement savings generated throughout a worker's tenure, or home equity. Such investment-oriented assets require the savings to remain untouched for maximum benefit. Such plans tend to receive tax-preferred treatment and discourage—through complex access rules or financial penalties—any early or unanticipated withdrawals made for a purpose other than the original intent. In the short or intermediate term, the value may fluctuate depending on proximity to the stock or bond markets and the degree to which the investment is diversified. Further, investment accounts are usually not federally insured and thus not safeguarded from potential loss in the event of bank failure or loss in market value. For all these reasons and more, they are not suitable substitutes for shorter-term savings.

[1] See Constance R. Dunham, "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities," in Changing Financial Markets and Community Development: A Federal Reserve System Research Conference, eds. J.L. Blanton, S.L. Rhine, and A. Williams (Federal Reserve Bank of Richmond, 2001), 31-58. Although unrestricted savings may also be called "flexible" savings, this brief will not use this terminology to avoid confusion with "Flex" Accounts, which are a specific tax-preferred savings account provided in the workplace that can be used to cover a variety of health-care-related costs. When the term "flexible" is used here, it will apply to the *use,* not the type of savings.

[2] Savings may be diverted from pre- or post-tax income, but the latter does not generally reduce taxable income or benefit from tax-advantaged privileges, with the exception of a Roth IRA and limited other accounts.

Unrestricted savings can take many forms. The most common examples include the traditional demand deposit saving account and the certificate of deposit (as short as three months).[3,4] Households earning lower incomes and with lower asset holdings, and those with a weaker attachment to the mainstream savings options offered at banks and credit unions, may also utilize nontraditional products and methods to save. These include holding savings in the form of cash, jewelry, or gold, and over-withholding from a paycheck.[5]

Unrestricted Savings and Economic Security

A primary purpose for unrestricted savings is to smooth income. Income smoothing refers to addressing a cash shortfall when expenses exceed household income or ability to pay. This is often caused by a drop in income, perhaps brought on by unemployment or illness, or by an unanticipated expense, such as a car or home repair. Having ready money allows households to avoid drawing down restricted funds that may be set aside for a dedicated purpose and incurring penalties for accessing them.

Consumer research indicates that there is a correlation between emergency savings and avoidance of costly financial missteps. The Consumer Federation of America observes that individuals making less than $50,000 in November 2005 who had $500 in emergency savings experienced fewer incidences of unfavorable financial outcomes, overdrawing a checking account and not meeting monthly minimum credit card payment levels (both incur fees for the customer), taking a high-cost loan (e.g., payday, car title, pawnshop), and having difficulty paying mortgage or rent.[6]

Groundbreaking research by the Urban Institute has recently confirmed that households, at all income levels, are better able to weather a potentially destabilizing household event when liquid assets are present.[7] Following an adverse event—involuntary job loss, a health-related work limitation, or parental loss— households that are "liquid asset poor" (51.9 percent of the sample's population) are two to three times more likely than their counterparts, households with liquid assets, to face material hardship (e.g. food insecurity, trouble paying monthly housing, medical or utility bills, disconnection of a phone line or utility resulting from an inability to pay). This compelling evidence reinforces that liquid savings are indeed used as a lifeline during household downturns, and have an impact on households, of all income levels, in weathering the recovery from such events.

Having urgent liquidity needs but no liquid savings to meet the needs can result in households making nontraditional or unproductive economic choices. Households may forgo necessary purchases (i.e. food, medicine, winter clothing), rely on overdraft coverage (i.e. a loan made through their checking account), borrow from their employer or social network, or take on a small-dollar loan.

The consequences of taking such measures are not confined to the short term. Deferring bill payment, for instance, can compound into a chronic problem, and affect one's credit rating, as 35 percent of the FICO credit score is composed of bill-pay history. Advancing oneself cash from a credit card is another high-cost action that might be taken. Credit card companies are known to review a customer's 10-

[3] The Series I and EE U.S. Savings Bonds have minimum holding periods of 12 months. To encourage a minimum five-year holding, bonds redeemed between 12-60 months after purchase forgo three months of interest. U.S. Savings Bonds are exempt from state and local taxes, but interest must be paid upon redemption (Series E, EE, and I U.S. Savings Bonds) or the year in which the interest is received (Series H and HH U.S. Savings Bonds).

[4] Mutual funds such as money market accounts that are not insured against loss by the Federal Deposit Insurance Corporation (FDIC) may also be categorized as liquid savings, but are not as widely held by the majority of the population, and therefore are not a point of emphasis.

[5] Constance R. Dunham, "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities," 31-58, and Michael S. Barr, "Financial Services, Saving and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey," in *Insufficient Funds: Savings, Assets, Credit and Banking Among Low-Income Households*, eds. Michael S. Barr and Rebecca Blank (New York: Russell Sage Foundation, 2009), 66-96.

[6] Stephen Brobeck, "Understanding the Emergency Savings Needs of Low- and Moderate Income Households: A Survey-Based Analysis of Impacts, Causes and Remedies" (working paper, Consumer Federation of America, 2008). Survey conducted in 2005.

[7] Signe-Mary McKernan, Caroline Ratcliffe, and Katie Vinopal, "Do Assets Help Families Cope with Adverse Events?" (Washington, DC: The Urban Institute, November 2009).

year cash advance history, which negatively impacts future annual percentage rates if the amounts advanced are not repaid in full.[8] And lower-income households are turning aggressively to their credit cards, according to a 2008 survey.[9] They are incurring and carrying credit card debt for at least three months to cover essential expenses such as car and home repairs, purchase of a major household appliance, or income lost to layoff or job loss.

Relying on credit or forgoing consumption of basic necessities interferes with productive wealth building, which requires sound financial footing, the preservation of existing assets, and the acquisition of more productive assets. In sum, having precautionary savings can mitigate the financial effects of temporary cash-flow problems and thus play a significant role in promoting economic security.

How Much Do People Save—or Not?

The research about levels, preferences, and behaviors for unrestricted savings is more limited than the research about retirement savings and broader wealth holdings. However, select data sources—nationally representative surveys, national consumer polls, experimentally designed research and pilot programs—provide evidence that, in general, households are unable to meet their unrestricted or short-term savings goals. Because of the difficulty obtaining an accurate portrait of the presence and levels of unrestricted holdings, proxy measures, such as demand for fast credit, are discussed.[10] From a variety of perspectives, this analysis collectively confirms that large segments of the population likely have insufficient levels of unrestricted savings.

Households Express Preferences to Save for Precautionary Reasons

Irrespective of their actual saving levels and asset holdings, households repeatedly express a strong preference to save for precautionary or non-investment purposes.[11] From 1998-2007, the Federal Reserve Board's triennial Survey of Consumer Finances (SCF) reported saving for "liquidity" as the second most important reason to save (ranked never more than 4 percentage points behind retirement, which consistently ranked first).[12] Yet preferences and intentions are not always followed by immediate action, as the following section on behavioral economics demonstrates. Still, there is strong evidence that households recognize the importance of precautionary saving.

Current Liquid Savings Needs Exceed Holdings

Analyzing 2004–2008 survey data, the Consumer Federation of America (CFA) found that households with annual incomes below $25,000 predict spending $1,500 on unforeseen expenses, but ultimately spend approximately $2,000 yearly.[13] These figures are consistent with the figures reported by the Survey of Consumer Finances in the table below. CFA polling shows that one-quarter of these households possess a savings account with $500 set aside, suggesting that the remaining three-quarters of households with incomes below $25,000 are not formally saving at all. Moderate-income households classified as earning $35,000 to $50,000 annually perceive typical emergency savings needs of $3,000; however, less than half of this population have savings accounts, and less than half hold emergency savings of at least $500.

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8 Joshua M. Frank, "What's Draining Your Wallet?" (Washington, DC: Center for Responsible Lending, December 16, 2008).

9 Jose Garcia and Tamara Draut, "The Plastic Safety Net: How Households Are Coping in a Fragile Economy" (Demos, 2009). Findings represent the 41 million individuals in 15 million households carrying credit card debt for longer than three months.

10 The chapter titled, "Asset Holdings and Liabilities," in Signe-Mary McKernan and Michael Sherraden's, *Asset Building and Low-Income Families (Washington, DC: Urban Institute Press, 2008),* thoughtfully analyzes the most relevant wealth and asset building data and should be consulted as a resource for this topic..

11 Survey research among the underbanked populations nationwide and of lower-income New York and Detroit populations reveals the most important savings motives are precautionary and to be prepared for unexpected emergencies.

12 B.K. Bucks, A.B. Kennickell, T.L. Mach, and K.B. Moore, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finance* (Washington, DC: Federal Reserve Board of Governors, 2009), A10. Retrieved April 14, 2009, from http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf. Data from the triennial, nationally representative Survey of Consumer Finances should be interpreted knowing that higher wealth households are oversampled.

13 Stephen Brobeck, "The Essential Role of Banks and Credit Unions in Facilitating Lower-Income Household Saving for Emergencies" (Consumer Federation of America, June 2008).

Table 1. Desired Precautionary Saving, by Income
Data from the 2007 Survey of Consumer Finances (2007 dollars)

Income percentiles*	Approximate Amount of Family Income	Desired precautionary savings (median)	The share of income households wish to save for precautionary purposes (median)
Bottom quintile (0-19.9)	$0 - $20,599	$2,000	14.0%
Second quintile (20-39.9)	$20,600 - $36,499	$3,000	9.7%
Third quintile (40-59.9)	$36,500 -$59,599	$5,000	9.4%
Fourth quintile (60-69.9)	$59,600 - $98,199	$5,000	7.6%
Bottom ½ of top quintile (70-89.9)	$98,200 - $140,899	$10,000	8.1%
Top ½ of top quintile (90-100)	$140,900 -	$20,000	8.8%

Source: Bucks et al, Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finance, 2009, Tables 3.1 for precautionary savings data and Appendix A.2 for Percentiles of Income data.
Note: Across income groups, the median amount of desired precautionary income is $5,000 and median ratio is 9.2 percent.
*Income quintiles are obtained by ordering the sample by income, then evenly dividing the population by five.

A July 2009 HSBC Bank consumer survey revealed that upper-income households also lack sufficient liquid savings. Less than 30 percent of households with incomes greater than $100,000 report holding enough liquid savings to sustain them for three months in the event of sudden income suspension, according to the online survey. Overall, the nationally representative survey of 1,000 people showed less than 40 percent have three to six months' living expenses saved in an emergency fund.[14]

Households respond to economic shocks with assets that can be liquidated, meriting an overview of the asset poverty measure and recent data. Asset poverty is commonly defined as the inability to cover three months of basic living expenses at the poverty level (with liquid reserves), in the event of total income loss. Two recent analyses (using different data sources) estimate asset poverty affects 22.5 percent and 30.6 percent of the nation. In comparison, the 2006 income poverty rate, the share of the population living on a cash income below the federal poverty level, measured at 12.3 percent. This suggests that asset poverty is both a powerful metric for understanding unrestricted savings levels and also a financial state that affects a greater number of people than are generally categorized as impoverished.

Analyzing Survey of Income and Program Participation data, the Corporation for Enterprise Development reported that in 2006, 22.5 percent of households were asset poor; at the same time, fully 14.3 percent of households had zero or no net worth and were 'extremely asset poor'.[15,16] Using

[14] HSBC, "Americans Saving More but Still Not Enough," (September 3, 2009).
http://www.hsbcusa.com/ourcompany/pressroom/2009/news_09032009_hsbc_omnibus_survey.html.
The same survey reports that 51 percent of households earning $50,000 annually would last one month on their current savings.

[15] Corporation for Enterprise Development (CFED) Assets & Opportunity Scorecard (September 21, 2009).

2007 Survey of Consumer Finances (SCF) data, the Urban Institute arrived at 30.6 percent asset poverty calculating that a family of four is *liquid* asset poor if it has less than $5,300 in liquid assets.[17] By this definition, as many as 67.9 percent of families in the bottom quintile and 46.6 percent of families in the second quintile were similarly categorized.

Proxy Measures to Understand the Unmet Needs for Unrestricted Savings

Without extensive data on the prevalence of unrestricted holdings, proxy measures are needed to supplement our understanding of how and when households access ready money. The assumption is that people holding few liquid savings may turn to their restricted savings accounts when faced with an emergency. This means they forgo the financial incentive for leaving that money untouched, in order to have access to their funds. Experience in several demonstration projects suggests a strong demand for accessible funds and that participants are willing to draw down on dedicated funds in urgent times.

Since 2008, the New York City Office of Financial Empowerment has operated the $aveNYC Program, which incentivizes low-income tax filers to commit to save at tax time by offering to match up to 50 percent of a participant's tax-time savings deposit, provided the client leaves this savings untouched for one year. Of the small number of $aveNYC accounts that closed prior to the one-year mark when participants receive the financial match, the majority (57 percent) were reportedly closed due to participant withdrawal of savings for an emergency, children's expense, or job loss.[18] A similar phenomenon was observed in the 10-year American Dream Demonstration (ADD), in which nearly two-thirds of participants (64 percent) withdrew funds from their individual development account (IDA) for a purpose for which matches were not provided.[19] Participants who withdrew money from the restricted savings account lost $892 in program match money on average. The withdrawal activity from these two groundbreaking programs that incentivize saving illustrates not only that demand for ready funds exists (moreover, demand from individuals proactive enough to have self-selected into the programs), but that the need is so great that participants are willing to forgo sizable sums of matching money to get access to savings.

Borrowing from a tax refund and future paycheck are other indicators of unmet needs for unrestricted savings. Though the actions may be more expensive, they are rationally explained by a household's pressure for immediate liquidity. The Children's Defense Fund estimates that in 2006, more than one-fourth of all Earned Income Tax Credit (EITC) returns eligible for a refund requested a

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http://scorecard.cfed.org/financial.php?page=asset_poverty_rate. The scorecard reports the income range for the middle class: the income range is $44,801-$68,800. Moreover, women were 1.19 times as likely to be asset poor and minorities 2.27 times as likely to be asset poor than whites. The national average obscures that asset poverty varies by state, ranging from relatively low in Virginia, at 14.8 percent, to 32.5 percent in New York.

[16] The U.S. Census Bureau-sponsored Survey of Income and Program Participation (SIPP) collects the following asset-related information: home, vehicles, farm or business assets, interest earning banking assets, interest earning nonbanking assets, equities, personal retirement—IRA and Keogh accounts, employer-provided retirement accounts, including Thrift Savings Plans, and other assets such as mortgages. SIPP also captures data on labor force participation, taxes, liabilities, and participation in government transfer programs. SIPP tracks households in a continuous series of national panels (from 2 ½ years to 4 years), making it possible to compare comparing changes in asset holdings over time.

[17] The Urban Institute researchers include the following as liquid assets: transaction accounts, certificates of deposit, mutual funds, savings bonds, stocks, retirement accounts, the cash value of life insurance, annuities and trusts, and other financial assets; net worth includes net financial assets, and net nonfinancial assets (e.g., equity in vehicles, businesses, and homes).

[18] Cathie Mahon, "Innovations in Savings: The $aveNYC Account" (presentation, New America Foundation event: "Creating a Save and Invest Economy at Tax Time" (April 21, 2009).

[19] Mark Schreiner and Michael Sherraden, *Can the Poor Save? Saving & Asset Building in Individual Development Accounts* (New Brunswick, NJ: Transaction Publishers, 2007), 137-139. In the American Dream Demonstration, matches are provided for home purchase, postsecondary education, and microenterprise. Eleven programs provided matches for job training and technical education, eight programs matched home repair and remodeling, and four matched retirement savings. In the entire ADD sample, unmatched withdrawals were made in relatively small increments ($124). The average individual making an unmatched withdrawal lost an estimated $892 in match money (calculated by multiplying the value of unmatched withdrawals made by the typical participant with unmatched withdrawals, $504, by the average match rate of $1.77 for every $1 contributed by the IDA participant). These two points—the relatively small withdrawal amounts, combined with the cumulative amount of free money forgone for making repeated small withdrawals—suggest that the IDAs, designed to support longer-term asset-building goals, were perhaps the only funds available to cover urgent needs. The authors postulate that unmatched withdrawals might have resulted from income fluctuations or a dire need for cash in the short-term; participants having reached their saving goal, and having excess savings to spend; or the accrual of savings without a purpose for which participants would receive a match.

Refund Anticipation Loan (RAL), a high-cost loan against the expected refund.[20] In subtracting the $100 average RAL fee from the refund, RAL purchasers lost nearly 8 percent of their total federal refund, just to receive their money more quickly.

The dearth of liquid savings holdings could reasonably explain why clients take on high-cost loans. Having emergency or unanticipated expenses that cannot be covered by current cash flow is one certainty on which all households can rely, yet the majority of working-poor households, and a growing number of middle-income households, remain unprepared. The alternatives to no savings are inferior; and the payday loan industry size, estimated at $28 billion-$48 billion annually, suggests that urgent liquidity needs persist as both a consumer problem and a profitable business proposition.[21] The lack of personal savings to tap in urgent times may have contributed to the rise of a nonbank payday loan industry serving cash-poor, liquidity-pressured populations.

Evidence now shows that repeat borrowers are generating a large share of the payday loan demand, which means that while the scope and severity of the problem is still vast, the demand may be falsely inflated by the structure of a predatory loan.[22] Absent competitive alternatives to the payday loan and state regulation banning high fees and short loan terms, customers may continue patronizing payday lenders (where a typical customer will pay $498 in fees to finance a short-term $325 loan, bringing the total loan cost to $793).[23]

The above demonstrates that while individuals may hold a preference for saving, a tendency to under-save for the inevitable emergency, unexpected expenses, or monthly bill may result in consumers taking on high-cost products to meet immediate needs when their own reserves are tapped dry. The next section begins to identify the obstacles to saving.

The Personal Savings Rate: A Useful Measure for Unrestricted Savings?

The U.S. Department of Commerce's Bureau of Economic Analysis computes the Personal Savings Rate (PSR), a composite measure equal to total discretionary income less total outlays (i.e. income less expenditures) in the macroeconomy. PSR tracking has surged lately, undoubtedly because of the sudden rise in personal savings. But how relevant is the PSR when discussing emergency savings? The answers lie within the methodology and review of the PSR's strengths and weaknesses.

First, the value added by the Personal Savings Rate is that it allows for observing savings trends over time, and to capture large movements in earning and consumption. But its shortcomings, particularly as a source of information on unrestricted savings, are many. As an aggregate data measure, the PSR does not isolate if the difference between income and consumption is owed to a reduction in spending (which may lead to savings), or to an increase in income, or both. The PSR assumes that all discretionary income is saved, and the measure does not capture whether individual savings are generated by debt repayment.

Lastly, as an aggregate figure for the macroeconomy, it is largely driven by the consumption patterns of households with greater levels of income, and is not a revealing indicator of savings levels for households with lower incomes and fewer resources.

[20] Children's Defense Fund, "Avoiding the Pitfalls of Refund Anticipation Loans," March 2009, Figure 3. http://www.childrensdefense.org/child-research-data-publications/data/ral-report-2009.html.
In contrast, only 4 percent of non-EITC filers took out a refund.

[21] Estimates vary by source. See Christine Bradley, Susan Burhouse, Heather Gratton, and Rae-Ann Miller, "Alternative Financial Services: A Primer" (FDIC Quarterly, Volume 3, No. 1, 2009).

[22] See Leslie Parrish and Uriah King, "Phantom Demand," (Washington, DC: Center for Responsible Lending, July 9, 2009). According to a recent analysis of public data, loan "churning"—taking on a new loan within two weeks of repaying the previous loan—is responsible for 76 percent of the total payday loan volume and costs consumers $3.5 billion in fees annually.

[23] Uriah King, Leslie Parrish and Ozlem Tanik, "Financial Quicksand" (Washington, DC: Center for Responsible Lending, November 30, 2006).

Why Do Households Lack Sufficient Unrestricted Savings?

Low- and moderate-income families and those with low savings are challenged to accumulate savings by a variety of factors. Stagnant or low wages leave households with limited discretionary funds available to save for future use.[24] Strict and inconsistent eligibility guidelines for public assistance programs can discourage saving and developing formal attachment to depositories, and perpetuate the belief that a modest amount of savings or assets will disqualify one from public assistance.[25] Moreover, there are rational arguments to defer saving; for instance, the need to buy basic necessities or repay debt may take precedence in certain scenarios. In a low-interest-rate economy, it may also indeed be rational to encourage someone not to save, if the rate of inflation outpaces the rate of return on today's savings accounts. Repeat use of informal financial services, such as check-cashers, remittance providers, and payday lenders, may also explain low saving behavior. Though individual circumstances and banking preferences like those described above play an important role, behavioral and structural factors greatly influence savings outcomes and can erect obstacles to saving.

Structural Impediments to Increased Savings

A serious obstacle to saving for precautionary purposes is the limited access available to affordable savings options. Being "banked" with a depository and being eligible for the saving options are two key pieces of solving the access issue. The third is affordability. Compared with the often modest amounts contributed to emergency-use savings accounts, fees for maintaining the accounts are quite high.

[24] While the lower-income consumer segment saves less than upper-income households, the Detroit Area Household Financial Services Survey finds that low income is the most common barrier to savings (29 percent of respondents said their expenses were greater than their income.) A Consumer Federation of America survey in 2007 found that low savers reported "low or unreliable income" more commonly than high savers.

[25] Rourke O'Brien, "Ineligible to Save," (Washington, DC: New America Foundation, September 2006).

Access

Being "banked" implies access to a safe, insured savings product. Originally crafted during the New Deal, the innovation of FDIC insurance was that it offered depositors assurance that their savings were protected, even if the bank failed. Being "banked" also makes saving easier, more likely and safer.[26] Though, as previously established, people can and do save outside formal depositories, the need for a low-cost, transparent savings account remains. According to a representative sample of the underbanked population, more than half (53.2 percent) of the unbanked lack any type of savings (account or physical-based), whereas only about 20 percent of banked individuals lack them.[27] The latest and most comprehensive analysis estimates that approximately 9 million people or, 7.7 percent of all U.S. households, are unbanked. [28]

Another reason households are unbanked is because of limits on the places they can save. Besides banks, only employers and tax preparation businesses are likely to interact with the unbanked on financial matters. Tellingly, a GAO study found that only 7 percent of the financial institutions surveyed offer savings accounts through employers and only 3 percent participate in the Volunteer Income Tax Program by offering free tax preparation to low-income clients.[29] And where the unbanked are conducting their financial transactions—not with depositories but with retail financial businesses—they are

[26] Constance Dunham, "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities," 41 (Figure 10). Banked individuals are more likely to save regularly than unbanked individuals with similar household incomes.

[27] Michael S. Barr, "Financial Services, Saving and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey" in *Insufficient Funds: Savings, Assets, Credit and Banking Among Low-Income Households*, ed. Michael S. Barr and Rebecca Blank [New York: Russell Sage Foundation, 2009], 66-96.

[28] *FDIC National Survey of Unbanked and Underbanked Households* (December 2009). http://www.fdic.gov/unbankedsurveys/unbankedstudy/FDICBankSurvey_Report.pdf.

[29] GAO, "Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts." Authors note that the results are not generalize-able to all financial institutions. Review included Web site reviews, 185 branch visits, and Federal Reserve data.

not offered savings opportunities or products.[30] One exception among prepaid debit products, NetSpend, does offer customers an easy process for segmenting funds in their own savings account, and promotes an attractive five percent return on savings deposits.[31]

Eligibility

While individuals generally do not have problems with becoming eligible to open a bank account, many face qualification challenges when trying to access a savings product at a depository institution. Checking or savings accounts closed previously as a result of mismanaged or fraudulent activity are usually reported to a central clearinghouse, called ChexSystems.[32] Though by themselves stand-alone savings accounts (without check-writing ability) by design have limited ability to defraud an institution, the majority of banks (80 percent) also require that a customer pass a third-party screening prior to opening a savings account.[33]

In the FDIC February 2009 *Survey of Banks' Efforts to Serve the Unbanked and Underbanked*, among the most commonly cited reasons for declining a new account application is "negative account screening." A quarter of these banks automatically reject new applicants for appearing in the ChexSystems database.[34] Also, big banks are more likely to rely on credit reports as a screening tool.[35] The end result is that many households cannot even begin to save through a formal financial institution because they are unable to open an account as a result of a ChexSystems record. Banks are overly reliant on the ChexSystems screening, ultimately disenfranchising potential customers because of their perceived financial risk.

Affordability

While 97 percent of institutions offer basic savings accounts—defined as accounts with balances under $500 [36]—the structure of today's basic account can discourage low-balance savers. Account fees and minimum balance requirements can raise the cost of holding these accounts considerably. While these account costs may seem modest, in absolute terms they are not, relative to the discretionary income or regular savings amount of the typical household earning low- or moderate-income wages. Thus, they function as a deterrent to would-be savers.

Traditional demand deposit savings accounts typically require an initial deposit and the maintenance of a certain minimum daily balance threshold. The Consumer Federation of America (CFA) reports that banks and credit unions will, in practice, lower such thresholds (e.g., reduce a $300 initial deposit to $25 or $50) if the customer agrees to regularly transfer $100 to $300 into the savings account each month. Some banks may also add the stipulation that the transfer originate from a checking account at the same bank. However, these practices do not necessarily reduce existing barriers enough for households with low and unsteady incomes.[37]

CFA conducted a series of in-depth interviews with financial institutions and found that it takes a balance of between $500 and $1,000 for a savings account to be profitable.[38] Such a stand-alone account will net the financial institution $20-$40 annually, after calculating interest payments and account servicing costs. The business case is harder to justify for lower account

[30] See the homepage for Prepaid101, which compares offers for prepaid debit cards: http://www.prepaid101.com/
[31] Sherrie Rhine, Katy Jacob, Yazmin Osaki, and Jennifer Tescher. "Cardholder Use of General Spending Cards: A Closer Look at the Market" (Chicago, IL: The Center for Financial Services Innovation, 2007). In their analysis of branded reloadable general spending cards, the authors observe that adding a savings feature to a prepaid card can promote "stickiness," also understood as prolonged use or continued patronage.
[32] A ChexSystems report identifies whether the following have occurred in the last five years: account closure; outstanding debit balances; non-sufficient funds checks that have not been paid; accounts applied for in the most recent 90 days. The screen also matches the applicant's Social Security number and driver's license number with what is in the system.
[33] Dove Consulting, "*FDIC Survey of Banks' Efforts to Serve the Unbanked and Underbanked*" (February 2009), 187, http://www.fdic.gov/unbankedsurveys/unbankedstudy/FDICBankSurvey_Report.pdf . This number increased to 87 percent for a checking account.
[34] Ibid., 193, Figure 1. Reason for Declining Applications
[35] Ibid., 194, Figure 3. Calculated Rankings by Tier

[36] GAO, "Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts."
[37] Referenced as an unpublished Consumer Federation of America survey of savings accounts at large banks (2007) in "The Essential Role of Banks and Credit Unions in Facilitating Lower-Income Household Saving for Emergencies," a working paper for CFA by Stephen Brobeck, June 2008.
[38] Ibid.

balances, which may explain a renewed emphasis on fostering strong customer and intermediary relationships, and exploring hybrid account products.

Given the range of bank cost structures and the challenge of getting stand-alone transaction accounts to generate revenue, banks have shown increasing interest in using a checking product or platform to promote saving. Popular savings programs like Bank of America's "Keep the Change" exemplify this consumption-focused approach. By offering to automatically round up to the next dollar every customer's point of sale purchase and to deposit the difference in a regular savings account, the bank establishes an additional account with a continuous revenue stream. "Keep the Change" customers benefit from automatic savings done on their behalf, but must spend in order to save, and thus may not accrue a meaningful amount of savings. Similarly, Wachovia's "Way2Save" program diverts not the difference but one whole dollar from every enrolled customer's purchase. The popularity of both programs demonstrates that customers appreciate banks' making saving easy and effortless. It also demonstrates that these two banks are keenly aware of the costs of a basic savings account, and have worked around those perceived high costs by trying to offset them with interchange fees paid by merchants each time their customers use their bank cards to make a purchase.

Financial institutions are creatively partnering with intermediaries (see the SmartyPig example in the Text Box to the right) and re-packaging basic products to attract new savers through a manner that is cost-effective to the depository. While this novel approach is useful for some, most families need a broader range of affordable saving options for different purposes.

Innovation in Consumption-based Savings

SmartyPig—a new online, goal-based savings platform that provides access to free savings accounts held at an FDIC-insured depository—is transforming saving by making it social, rewarding, and easy. SmartyPig's new program, which incentivizes specific "store or site destination" savings, is yet another example of consumption-based saving. In this case, a customer's savings are matched with a financial contribution ranging from 2 to 12 percent, a high interest rate if the designated savings are spent at a particular retailer. Customers get the SmartyPig "boost" only if they make the purchase using a SmartyPig debit card, onto which the boost has been loaded. While this makes reaching the goal of saving for a necessary good such as a refrigerator easier, it is not possible to receive the matching funds or high return on savings for a necessary expense that is not retail based.

Behavioral Economics and Saving

Behavioral economics is a field of study premised on the assumption that individuals do not consistently behave as rational economic agents in constant pursuit of welfare maximization. This emerging perspective challenges the neoclassical models on which most saving and consumption theory is based.[39] By infusing the traditional neoclassical economic models with an appreciation for the social context in which humans make decisions, behavioral economics can offer a realistic explanation of how people actually behave, as opposed to how theory *assumes* they behave. Thus, the behavioral economic perspective can explain what a neoclassical economist would in most cases describe as irrational behavior: under-saving when savings needs have been identified. This is particularly germane to

[39] Relevant neoclassical assumptions are as follows: (1) individuals make decisions that will maximize their own utility (i.e. that will best advance their own interests); (2) individuals are rational (i.e. they will do what is in their best interest and choose to do so repeatedly); (3) individuals make decisions based on full information.

a savings discussion in which, at least according to the research, intent to act is not followed by rational savings behavior. Specifically, four behavioral-informed explanations that impact saving for unrestricted purposes, are worth considering.

The 'present self' versus the 'future self'

Behavioral economics research confirms that individuals often forgo decisions that would maximize their distant future well being, to act upon benefits that can be realized in the near term. This tendency, called "temporal discounting," occurs because people discount gains expected in the future, and inflate the perceived value of what can be consumed immediately. Because to save is to forgo consumption, the act of saving requires individuals to overcome this tendency to want to consume immediately. The internal conflict between "present self" and "future self" is further challenged by the need to plan for what does not yet exist. Altogether, this increases our chances of being underprepared for the inevitable adverse event and can even contribute to a pattern of over-borrowing.[40] This is manifest in small emergency fund holdings, particularly by those who have the knowledge, intention, and discretionary income to set them aside. The "I'll start tomorrow" attitude plagues unrestricted savings, unlike retirement savings—which benefit from employer engagement that often contributes to greater participation.

Losses hurt more than gains and we act accordingly

A second explanation for under-saving for the short term is a discomfort with feeling as though we have lost: behavioralists call this "loss aversion."[41] This manifests in feeling losses more than gains; in turn, we are motivated by, respond and react more strongly to a potential negative outcome than to one presented as a potential gain. Stated differently, we are more likely to actively avoid a choice that feels like a loss (e.g., a drop in salary), then act on a choice that maintains the status quo or moves us to a better financial position. This makes forgoing consumption today (again, the definition of saving) difficult because due to this loss aversion, we are sensitive to the loss of discretionary income, it can feel like we are losing discretionary income, rather than gaining financial security.

In one of the first applied behavioral experiments, the Save More Tomorrow (SMarT) program sought to help employees increase retirement contributions using a pre-commitment plan. Employees were defaulted (but allowed to opt out), into the option of having the amount of their next pay increase diverted to their existing retirement savings account.[42] Researchers overseeing the SMarT experiment postulated that by diverting additional money employees were expected to receive in three months (future gains), workers would not feel a loss in their income and thus choose to participate in SMarT. The first implementation of SMarT was successful: only 3% opted out of the SMarT plan prior to the second pay raise, and employee groups least likely to save showed increased gains in their saving rates.[43] As explored below, SMarT also demonstrated that simplicity (here, limiting the number of steps required by the employees) increased participation, and was a key component to overcoming behavioral tendencies.

We struggle to make one choice when presented with many

Behavioral economists postulate—and have confirmed through applied research and evaluation[44]—that when an

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[40] Suggested that lending agencies exploit this "temporal discounting" and liberally offer credit without verifying the borrowers' ability to repay. See Michael S. Barr, "Behaviorally Informed Home Mortgage & Financial Services Regulation" (presentation,, Corporation for Enterprise Development event: "Assets Learning Conference" (September 12, 2008).

[41] Amos Tversky and Daniel Kahneman, "Loss Aversion in Riskless Choice," *Quarterly Journal of Economics* 106 (1991): 1039-1061.

[42] Richard Thaler and Shlomo Benartzi, "Save more Tomorrow: Using Behavioral Economics to Increase Employee Saving," *The Journal of Political Economy* 112 (February 2004), 164-187.

[43] Ibid., 174. The average savings rates of enrolled participants increased from 3.5 percent to 13.6 percent over four annual pay raises, in the first implementation of SMarT. Results are for workers at a midsize manufacturing company who self-selected into the SMarT program and reported saving very little prior to enrolling in SMarT.

[44] Among employees who perceive their savings rate as too low and plan to increase savings, most fail to take any action, supporting researchers' hypothesis that employees take the path of least resistance when saving (James Choi, David Laibson, Brigitte Madrian and Andrew Metrick, "For Better or For Worse: Default Effects and 401 (k) Savings Behavior," in *Perspectives in the Economics of Aging,* ed. David Wise [Chicago: University of Chicago Press, 2004], 81-121). In a survey of 1,202 randomly

individual is faced with a complex set of options, he will engage in "passive decision making" and lean toward choosing the option that requires the least amount of cognitive and corporeal effort.[45] Though this "information overload" may impede our ability to choose one best option among many, we still prefer having at least a few options to having none. Whereas experiments have documented these trends for retirement and future salary advance increases, we still have not fully studied how these experiments hold up for shorter-term savings plans where fewer barriers to access and behavioral controls exist. The closest example may be in the informal retail financial services sector, where customers receive limited choice presented with transparent fees, and reportedly find this format attractive and easy to understand. The growth charts for these fields suggests that the models are thriving.[46] (Important note: not all alternative financial services (AFS) products and their costs are equally transparent. Among the most easy to understand are check cashing and remittances; payday loans are more likely to obscure total costs).

We have sociological, emotional relationships with money and financial services

As we are highly sensitive to social cues and context, norms and expectations, having a negative banking or saving experience that introduces trust or discomfort can discourage regular or would-be savers. Despite the evidence showing that households of all incomes are capable of saving under the right circumstances, one's perception can dictate whether one chooses to save. For example, the belief that one does not have "enough" to save or that "Banks are not for me…they make me feel poor" are commonly invoked sentiments.[47] Importantly, underbanked low- and moderate-income households are supplementing or in some cases, substituting entirely, the formal financial services industry with non-bank services, provided through financial service intermediaries in more comfortable and convenient settings.[48]

Our relationship with money exists not just in our wallets but in our heads. Money is often described as ephemeral and fungible, easily interchangeable in physical or mental terms. New evidence explains that we may even treat money differently depending on the way it comes to us. According to business marketing professor Dan Ariely, *how* one receives a refund (direct deposit versus paper check), not necessarily *how much* one receives, dictates the likelihood of spending versus saving that money.[49]

In fact, the socio-emotional considerations are often so important that they outweigh rational choices about the costs of the services and their effect on pocketbooks. Though financial costs of our decisions can be high, we tend to weight personal preference even higher. The Brookings Institution recently calculated that a worker currently using nothing but retail non-bank services could save more than $40,000 over his or her career by using a low-cost checking account instead of a check-cashing service for routine transactions.[50] However, millions of

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selected employees at a 10,000-person company, researchers found that employees who think they save too little, and plan to save more, actually do not follow through with those intentions. Out of every 100 employees surveyed, 68 reported saving too little. Of those 68 employees, 24 said they intended to increase their retirement savings, yet only three of those actually did. The passive decision-making hypothesis held during an experiment where offering more investment options reduced the likelihood of a consumer taking any action (Iyengar, Sheena S., Gur Huberman, and Wei Jiang, "How Much Choice Is Too Much? Contributions to 401(k) Retirement Plans." in *Pension Design and Structure: New Lessons from Behavioral Finance,* ed. Olivia Mitchell and Stephen Utkus [New York: Oxford University Press, 2004], 83-95). Conversely, simplifying the number of plan options increased the likelihood of participation in a savings plan--compared to relying on individual decision making and opt-in savings.

[45] James Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "Defined Contribution Pensions: Plan Rules, Participant Choices, and the Path of Least Resistance," National Bureau of Economic Research Working Paper No. 8655. Cambridge, MA: National Bureau of Economic Research, 2002, 67-113.

[46] Christine Bradley, Susan Burhouse, Heather Gratton, and Rae-Ann Miller. "Alternative Financial Services: A Primer" (FDIC Quarterly, Volume 3, No. 1, 2009).

[47] Edna Sawady and Jennifer Tescher, "Financial Decision Making Processes of Low-Income Individuals," Joint Center for Housing Studies (Harvard University, February 2008, UCC08-2), 8.

[48] Customers cite convenience, transparency of fees, and accessibility, among the reasons why they frequent these informal businesses (Ellen Seidman, Moez Hababou, and Jennifer Kramer, "Getting to Know Underbanked Consumers: A Financial Services Analysis," Center for Financial Services Innovation, September 2005).

[49] Mark Lieberman, "Economic Stimulus Rebate: More a 'How' Than a 'How Much' Question," FOXBusiness Monday, March 24, 2008. http://www.foxbusiness.com/markets/economy/article/economic-stimulus-rebate-question_530364_3.html

[50] Matthew Fellowes and Mia Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential," (The Brookings Institution, January 2008).

Americans continue to frequent check-cashing services. For workers who know they are not choosing the financially optimal outcome by paying per-transaction, their desire to feel comfortable compels them to frequent these informal institutions. Though these retail nonbanks may provide trust, transparency, and speed of transaction, their status—that of a not-insured depository—makes it impossible to receive a savings deposit or offer a savings product.

Saving behavior is often irrational behavior

As illustrated through the four behavioral economics principles, the human tendencies to discount future gains, rely on a perceived loss to motivate our behavior, struggle to choose one option when presented with many, and weigh the psycho-social components of personal finances have a significant influence on saving behavior. Being able to understand how behaviorial economics influences saving would be useful for policymakers and practitioners alike; they could then use that knowledge to develop realistic pro-savings approaches. Without a concerted effort to improve saving behavior with appropriate policies, low liquidity levels are likely to persist. Behaviorally informed policies show promise in leading to behavior change and increasing savings. The issue now is not whether, but *how,* policy makers should use these mechanisms and knowledge of decision making to promote savings, not deplete it.

AutoSave: Leveraging Behavioral Economic Insights to Increase Saving

AutoSave is a unique savings plan (developed by the New America Foundation and MDRC with support from the Rockefeller Foundation and the Charles Stewart Mott Foundation), that diverts via payroll deduction a small amount of post-tax wages into a newly created savings account. Unlike most existing workplace savings programs, which focus on building retirement assets, AutoSave savings are intended to be fully liquid, and available both to cover short-term needs and, potentially, to increase attachment to mainstream financial services or serve as building blocks to longer-term asset accumulation.

In fall 2009, five employers located across the US began official participation in the AutoSave pilot. These firms will offer new savings accounts on behalf of a financial institution and will facilitate the ongoing contribution of post-tax employee wages into these accounts on behalf of their employees, using direct deposit and split pay technologies.

The AutoSave concept was envisioned as an intervention that would maximize the behavioral economics insights that influence saving decisions. To ensure the appropriate use of behaviorally-informed design features, the AutoSave team consulted behavioral economics experts from Ideas42, the Harvard University-based laboratory for applied behavioral economics (supported by the Annie E. Casey Foundation).[51]

The assessment of the 2009 pilot will illuminate whether potential exists to explore the creation of a scalable AutoSave model that maximizes likelihood of participation and minimizes common barriers to saving; such as, inertia, indecision about how and how much to save, concerns about the safety or accessibility of funds, and time-consuming enrollment steps. If the pilot is successful, it may point the way to a deeper examination of the program's effects on saving, asset accumulation, and job stability.[52]

Exploring the Research and Policy Frontier

The weak financial footing of American households implores policymakers to examine how, in what form, and in what quantity households are saving, and to find ways to encourage unrestricted saving. But determining the presence and level of unrestricted savings is difficult for two reasons. First, few verifiable data sources accurately

[51] AutoSave is especially grateful to Mindy Hernandez of Ideas42.
[52] For a summary of the pilot's design and operational lessons, please see: Alejandra Lopez-Fernandini and Caroline Schultz, "Automating Savings in the Workplace," Washington, DC: New America Foundation, January 2010.

track liquid savings holdings[53] or distinguish it from tax-incented savings. Furthermore, available consumer polls are conducted infrequently and may be unreliable. Second, truly liquid funds that are most easily accessed are often held in checking accounts where they are mingled with cash funds, making it difficult to track holdings.[54] The Survey of Consumer Finances acknowledges this in the description of "transaction accounts" as a category that includes several savings vehicles: checking, savings, money market deposit accounts, money market mutual funds, and accounts held at brokerages. Elsewhere in the Survey of Consumer Finances, respondents are asked whether they saved in the prior 12 months and in what types of accounts. While 47 percent affirmed that they save, 80 percent of that group reportedly placed this savings in a 529 Plan, a tax-advantaged, college savings account.[55] As defined earlier, unrestricted-use savings are not comparable to tax-advantaged accounts and tend to be more liquid than the SCF categorizes would suggest.

To better understand the connections between unrestricted savings and economic security, more exploration is required along the research and policy frontier.

The Research Agenda

In terms of research, we need better data to provide a more accurate picture of holdings and flow of funds during cash shortfalls, especially by lower-income and middle-income (LMI) households. The Federal Reserve Board's Survey of Consumer Finances currently asks respondents to report their desired amount of precautionary savings. The survey results would be more helpful, however, if we knew *how much* precautionary savings were accumulated, *where,* and *how.*

Not well understood is whether and how multi-horizon savings goals interact. Does encouraging small-dollar, non-tax-advantaged savings detract from or encourage greater retirement savings or other targeted, incentivized asset-building saving? What is the relationship between emergency saving and credit, and what role does insurance have in preparing for financial emergencies? Quantitative and qualitative study could explore the aforementioned questions about household strategies for preparing for and responding to varying degrees of financial shocks. Such an analysis would call for study of household preferences, behaviors, and financial holdings and changes over time.

Additionally, pilot and rigorous experiments are needed to evaluate the role of such policy interventions as incentives, defaults, and restrictions to access. Large-scale, longitudinal studies and experimentally designed evaluations to determine causation are needed to understand why households, especially LMI populations, are not saving for unrestricted purposes and what trade-offs they are making to meet those emergency or large expenses.

Real-world pilots and demonstrations can be especially useful for answering behaviorally informed questions. The use and effectiveness of automatic enrollment and escalation to increase worker participation in 401(k) plans and other retirement salary-reduction plans suggest that choice architecture[56] can be a powerful strategy to change saving behavior.[57] But research on the effect of choice architecture on unrestricted savings is less understood, as the well-established studies are based on restricted-use savings that not only cost the employer more to implement,

[53] Here I define "liquid" savings as funds that may or may not be held in a traditional demand deposit account, but must be easily accessible and without financial penalty.
[54] Thus, somewhere in the "transaction" account holdings we can expect to find any non-tax advantaged savings or precautionary savings.
[55] Results held true for 2004 and 2007. According to 2007 SCF data, 89.7 percent of the survey sample hold checking accounts (this category includes regular savings); 47.2 percent hold tax-preferred savings accounts (80 percent are Coverdell or 529s saving plans, the rest are medical or health savings accounts); 20.9 percent hold money market accounts; and 2.1 percent use cash accounts at brokerages.

[56] A concept developed by Cass Sunstein and Richard Thaler that describes important design elements of a person's decision-making environment that influences their choices.
[57] Upon adopting auto-enrollment and auto-increase for their employees' retirement accounts, Nationwide Insurance and Vanguard each documented substantial increases in participation rates and retirement preparedness among their lower-wage workers. Nationwide's effects were particularly strong for workers earning less than $30,000, for whom the automatic change increased retirement investments by 77 percent, to a participation rate of 93 percent of employees at this earnings level. A similar effect was observed among Vanguard's employees earning less than $30,000: whereas 25 percent were participating prior to auto-enrollment, 77 percent adopted the employer's retirement plan after the policy was put in place.

but have been carried out by larger firms. Furthermore, the behavioral perspective presents a wide array of compelling research questions, including the impact of incentives and the psychological trade-offs between immediate consumption and planning for mid-term financial security.

An additional question for those interested in seeing unrestricted funds accrue is how much a*ccess to allow to one's unrestricted funds.* How few restrictions on access or how big a financial penalty can we put on unrestricted savings for it to be in the sweet spot of encouraging savings to grow, and not be raided by temptation? For example, is the IRS penalty of 10 percent on the pre-tax amount withdrawn from a 401(k) viewed as a less expensive choice than borrowing at today's credit rates? If a person's retirement holdings were modest, then a 10 percent penalty on that total amount could be small enough to not change one's behavior; that is, the 10 percent penalty is not a strong disincentive.

The most established savings regimes (home mortgage deduction, retirement interest deduction) encourage individuals to save by offering either a matched contribution or stinging them with a penalty for early withdrawal of their restricted savings. But as households undergo unexpected economic pressure, how compelling are the incentives of matches and penalties on saving? Relevant research questions might ask: How strong a match rate does one need to be encouraged to overcome the temptations to forgo the match and, in this scenario, address liquidity needs elsewhere? And, what evidence supports the effectiveness of restrictions on access?

Policy Development

Most of the attention given to savings in policy circles has focused on restricted-use savings as a means to build wealth over the long term and promote retirement security. Policy has traditionally overlooked how to encourage savings in the shorter-term, more flexible-use account. Yet most households have needs to access unrestricted savings in order to cover unanticipated expenses such as unusually high utility bills, travel fare to visit an ailing family member, or subsistence needs after job loss. There are a number of ways that public policy could be deployed to more effectively promote unrestricted savings and significantly enhance the economic security of large segments of the population.

First, policy emphasis should be placed on addressing and removing barriers where they can be identified. For example, many individuals are prohibited from opening savings accounts if they have negative marks in the ChexSystems database. However, this may be an excessive hurdle since demerits can be given for having an account closed due to unpaid fees or insufficient funds. Banks generally take a broad-brush approach and may decline to open accounts for individuals whose infractions may have been long in the past. Policy intervention may be required to streamline this process in ways that distinguish between minor and major infractions so that responsible applicants are not needlessly prevented from opening a savings account.

Policy could potentially play a role in improving product options. Households with modest savings goals find it difficult to afford simple savings accounts with affordable terms. Recurring fees, while low in absolute numbers, may be prohibitively high relative to the small dollar deposit activity. Coupled with today's low market interest rate, the standard savings product would not appear to be a rational choice on a cost-benefit basis. Building on the successful general spend, re-loadable card platform, new prepaid accounts should be structured to immediately offer the customer a place to save, as the SAFE-T Account proposal suggests.[58]

Thirdly, policies should encourage the use of existing infrastructures where they have proven to be successful in spurring saving. These include a greater promotion of direct deposit and split pay between multiple accounts. Employers who have yet to incorporate these payroll

[58] Melissa Koide, "The SAFE-T Account: A Proposal to Deliver a Low Cost, High Value, Transaction and Savings Account at Tax Time" (Washington, DC: New America Foundation, April 2009).

practices may be stymied by technological or administrative capacity, or may simply lack the will or understanding that these electronic payment strategies are promising strategies to encourage saving.

Lastly, public sector entities involved in financial inclusion pilots and campaigns should be required to demonstrate results for their investment, and heed encouragement by public leaders to innovate. Multi-stakeholder pilots such as "Bank On" and the FDIC Small-Dollar Loan Pilot Program should be rigorously studied, and best practices should be scaled and replicated. This could include the capitalization of an innovation fund for financial institutions to facilitate research and development focused on underbanked consumers. This would encourage banks—and other financial services firms—to engage in the kind of intensive research and planning they undertake in developing products and services for higher-income consumers. The goal would be to encourage innovation both in how products are structured and in how they are marketed and delivered, in hopes of strengthening consumers' financial preparedness. As New America Foundation research found, access to and use of bank accounts, when offered with financial education, resulted in prolonged use of the accounts, stable account balances, the acquisition of other financial products and increased chance of acquiring more financial education.[59]

Conclusion

In the medical care context, an emergency room visit will cost all involved—patient, provider, and insuring party—much more than affordable, preventive health care. Similarly, the cost of not saving is much higher to families and society than the cost of regular, small deposits to an accessible account.

Deposits in basic savings accounts will not earn aggressive returns of interest, or make up the majority of the wealth accumulated by a household over a lifetime of saving. However, such an account has broad utility at various points in a lifetime: for separating funds from everyday moneys; for use in times of need, for preserving a credit rating, for intentional, thoughtful purchases or investments; for serving as a vehicle for delivering financial education and related asset-building tools; and for establishing a promising relationship with a financial institution.

Households use unrestricted, liquid savings to weather economic shocks and to protect themselves from future unfavorable events. With evidence to confirm that the presence of liquid assets decreases the risk of financial hardship, it behooves policymakers to support the ability of households to save regularly in affordable, accessible mechanisms.

[59] Christi Baker and Doug Dylla, "Analyzing the Relationship Between Account ownership and Financial Education" (Washington, DC: New America Foundation, September 2007).

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