Nudges for Financial Health

Global Evidence for Improved Product Design

Despite good intentions, people often make less-than-optimal financial choices. In this series, we match insights from our global research in behavioral economics with specific financial service and product design opportunities both for providers in the U.S. and in other countries. Providers can use these evidence-based insights to expand financial inclusion, improve client offerings, and continue to promote financial health.

Count on Commitment

Helping clients stick to their goals and increase their savings balances with commitments

» FEATURED SOLUTION: COMMITMENT SAVINGS DEVICES

Commitment devices are voluntary, binding arrangements that people make to reach specific goals that may otherwise be difficult to achieve. When built into savings products, commitment devices can help address behavioral and social obstacles to saving by providing a mechanism that forces people to save according to their self-set plans. These devices vary in terms of commitment activity, consequence for failing to fulfill the commitment, and control over how savings are spent. “Hard” commitments feature financial penalties for failure, whereas with “soft” commitments, the penalty is primarily psychological, as in letting down oneself or one’s community.

WHY DO COMMITMENT DEVICES WORK?

People are “present-biased”
People prioritize today’s desires and needs over tomorrow’s and, as a result, systematically fail to make choices that will only benefit them in the future.

People lack self-control
People often intend to save money for a bigger expense, but find themselves spending it on more tempting and gratifying things, instead.

People are inattentive to the future
It can be difficult to remember the future. People often undersave because they don’t think about how much money they’ll need in the next month, year, or decade.

Social pressure prevents some from saving
Many people face pressure from their family and friends to share their earnings and savings.

TIPS FOR PROVIDERS IN DESIGNING COMMITMENT DEVICES

Commitment devices are not a new concept for financial service providers. From “Christmas club accounts” designed to help people save for holiday expenses, to certificates of deposit (CDs), U.S. providers have been offering commitment savings products for decades. Yet there are many more opportunities to integrate commitment savings products. When designing devices for their clients, providers should keep these three considerations in mind:

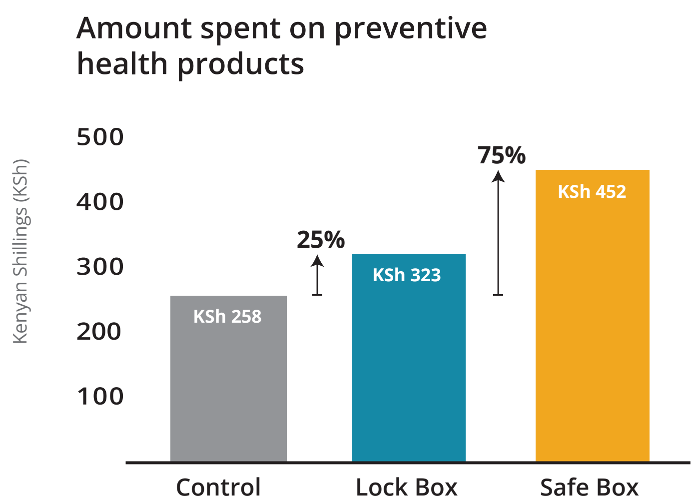
1. **Make sure there is a cost to *not* saving:** Commitment savings products must make saving the optimal choice for clients. That means devices must increase the *monetary* or *psychological* cost of not saving.
2. **Don’t scare away people who might benefit:** Providers do not need to make commitments extraordinarily expensive or taxing for clients. If devices tie people’s hands too tightly, they might not sign up for them.
3. **When it comes to restrictions, less can be more:** Commitment devices do not always have to impose restrictions to improve saving practices. Psychological commitments, like labeling savings for specific purposes or making non-binding public commitments to family or friends, can help people save more.

THE EVIDENCE

Rigorous evidence suggests that many clients voluntarily sign up for commitment savings products when offered them, and some even pay for the opportunity to commit. Across a diverse range of contexts and product types, commitment savings devices have helped people save more than they would have otherwise. Yet not all commitments work all the time; studies suggest that people would rather be nudged than shoved into saving. Here are two examples:

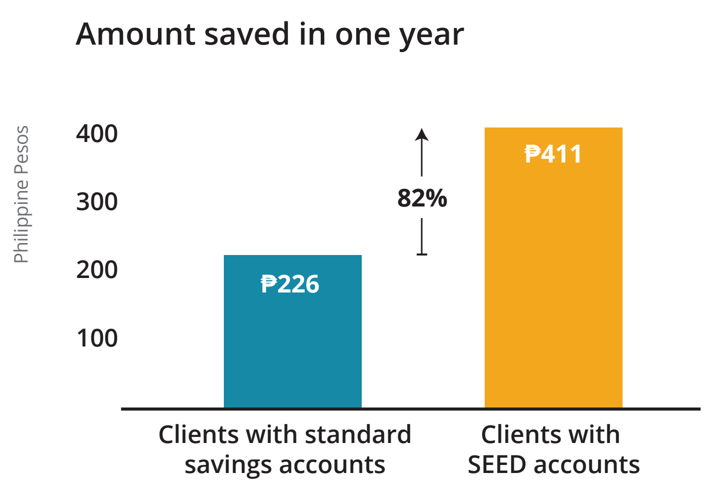
Simply labeling savings for health expenses helped families invest more in preventive health products in Kenya.

In Kenya, researchers found that simply providing people in pre-existing savings groups with a safe box (a metal box with a key they controlled), increased preventive health product investments by 75 percent in the following year. However, a hard commitment device—where people put money for preventive health in a locked box, and could not withdraw it for emergencies—had a much smaller impact over the same one-year period.[1]



Goal-oriented commitment savings accounts increased savings in the Philippines.

A commercial bank in the Philippines offered a savings product called SEED (Save, Earn, Enjoy Deposits) that prevented clients from accessing their funds until they reached a certain goal—either an amount or time period, *decided by the client*. Around one in three people offered the account opted to open one, and one in nine made regular deposits. A year after the offers went out, clients offered the accounts had increased their account balances 80 percent more than those with normal accounts.[2]



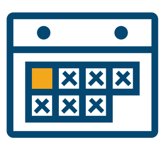
The Power of Doing Nothing

How defaults can improve customer savings behavior

» FEATURED SOLUTION: DEFAULTS

Automatic ("opt-out") enrollment is a simple product design modification in which consumers are informed they will be automatically enrolled in a product or service unless they choose to opt out. Setting the default to "opt-out" instead of "opt-in" has been shown to significantly increase uptake of certain savings products and lead to behavior change through automation, for example by increasing participation in retirement and savings plans. It is important that financial services providers use these tools with care, fully and conspicuously inform their customers about the product or service into which they will be enrolled, and give customers full freedom to make a different choice or opt out at any time.

WHY DO DEFAULTS WORK?



People prioritize today over tomorrow

People tend to get caught up in their busy lives and systematically fail to make decisions today that will only affect them in the future.

People put off taking action on complex tasks

People often avoid taking action on tasks that seem daunting or complex, and financial transactions like choosing a 401(k) plan are no exception.

People suffer from inertia

People have a strong preference for the status quo, regardless of whether it is better or worse for them than available alternatives.

WHERE CAN PROVIDERS AND NON-PROFITS APPLY DEFAULTS?

The most common use of defaults in the United States are automatic ("opt-out") enrollment in defined contribution retirement plans and regular escalation of contribution rates. Some other promising applications of defaults include:

- **Automatic deposits into savings:** For clients who have opened savings accounts, banks can automatically deposit a portion of their paycheck into their savings account, unless they opt out.
- **Automatic inclusion of savings add-ons:** Institutions can include add-on savings programs for clients unless they opt-out.
- **Automatic loan repayment:** Institutions can help clients pay down a loan by setting up automatic regular monthly payments for consumers, unless they opt-out.

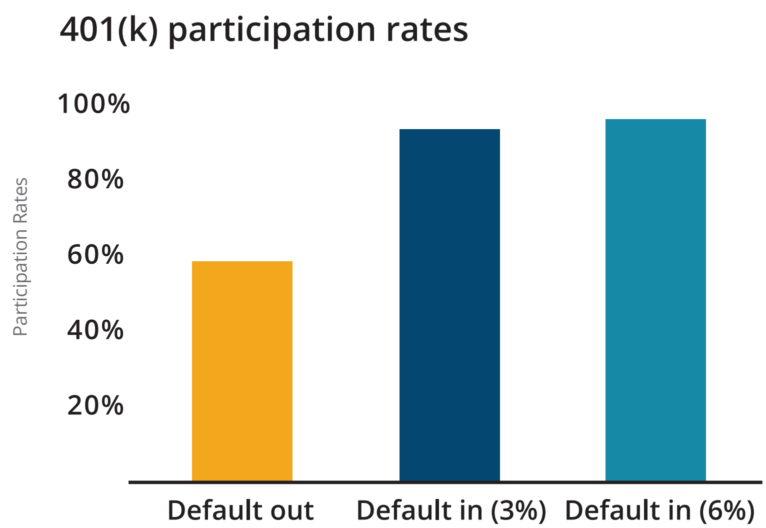
Although defaults can also be applied to savings contribution rates, optimal contribution rates vary for different individuals.

THE EVIDENCE

Research from around the world suggests that defaults affect savings at every step of the way, from the rate at which people participate in savings programs, to the amount people contribute, to the likelihood that people will increase their contributions over time.[3] These results are consistent across different contexts, suggesting people's response to defaults is a shared human behavior. The following two examples on the powerful effects of defaults, from very different contexts, suggest that defaulting people into retirement or savings plans is an effective way to increase savings balances.

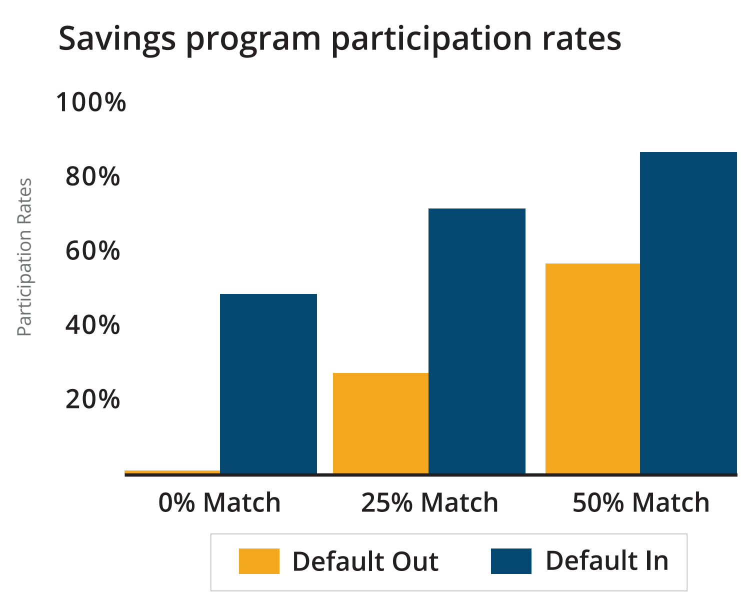
Defaulting new hires into retirement savings plans significantly increased plan participation in the United States.

After a large company began automatically enrolling workers in a 401(k) plan, participation rates for new hires went from 59 to 95 percent. When the employer changed the default contribution rate from 3 percent to 6 percent, it increased retirement savings amounts without reducing participation rates. The 6 percent default doubled the amount of people who contributed 6 percent of their pay, from 24 to 49 percent.[4]



Defaulting employees into automatic savings was as effective as a more costly 50 percent employer savings match.

A large employer in Afghanistan informed workers that, unless they chose to opt out, 5 percent of their paycheck would be automatically deposited into a mobile savings account. Employees in this program were 40 percentage points more likely to accumulate short-term savings than employees who had to opt in, equivalent to a much more costly 50 percent employer match. When the study ended and the default enrollment was removed, 45 percent of employees continued to contribute to their accounts.[5]



Top of Mind

Reminders can increase savings deposits at almost no cost to providers

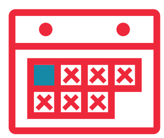
» FEATURED SOLUTION: REMINDERS

Providing access to savings accounts is an important step in bringing financial services to the poor, but access alone does not guarantee people will save. Many people struggle to develop good savings habits because they put off saving until a future time, or face so many seemingly urgent needs today that it is difficult to save for tomorrow, or they simply forget to save. Reminders that bring savings goals to the "top of mind" are a low-cost way to address these barriers and help clients reach their savings goals.

WHY DO REMINDERS WORK?

People tend to be inattentive to their future needs

People often fail to think about or budget for large future expenses—particularly "exceptional" expenses like a wedding or a new roof, or emergencies, which are hard to budget for.



People prioritize today over tomorrow

People tend to put their current desires ahead of their future needs, even when they are tempted to buy something they know they shouldn't. Temptation today makes saving for tomorrow particularly difficult.

People procrastinate

People often get caught up in their busy lives and delay taking action. They may intend to deposit money in a savings accounts, but never seem to find the time.

HOW CAN PROVIDERS AND NON-PROFITS APPLY REMINDERS?

Reminders have been proven to help people follow through on their goals and commitments. Providers can use them in various ways:

- **Helping clients save more:** Providers can use text messages (most cost-effective) or letters to remind savings account holders to save, or of specific savings goals.
- **Helping clients repay loans:** Text message reminders have been shown to increase the timeliness of loan payments and the amount of the loan that is repaid.[6] Importantly, in the one study, text messages were only effective when they included the name of the loan officer, which personalized the clients' obligation.
- **Helping clients follow through on important actions.** Personalized reminders have been effective in enforcing collection of unpaid taxes and submitting time-sensitive paperwork for financial aid in the US.[7,8] They could also be effective at helping people complete other actions, like opening and making deposits into a college savings account or refinancing a mortgage when rates go down.

THE EVIDENCE

Research from different countries shows that reminders—which are virtually costless when delivered by text—are a useful tool in fighting procrastination and helping people follow-through on their goals. In financial inclusion, they are a cost-effective way to increase saving balances. Outside of financial inclusion, they have been used by clinicians to help patients to follow through on weight-loss programs,[9] to quit smoking,[10] and to complete a full course of medication.[11] Below is an example of the impact of reminders on savings, from a study in three countries:

Getting to the Top of the Mind: How Reminders Increase Saving

In Bolivia, Peru, and the Philippines,[12] clients with commitment savings accounts who received messages reminding them of their savings goals saved more and were more likely to reach their goals than clients who did not receive the messages. Each bank sent monthly reminder messages, either by letter (Peru) or text message (Philippines and Bolivia). The reminders mentioned a client's savings goals, a financial incentive, or both a goal and an incentive. The reminders produced an average 3 percentage point increase in savings on a base of 55 percent. Since the text reminders were so inexpensive to administer, this approach was cost-effective for financial service providers.

What type of messages worked best?

» Messages that mentioned both a savings goal and a financial incentive were most effective.
» Messages that used positive versus negative motivation were equally effective.
» Regularly scheduled monthly reminders were effective. When a client was late in making a deposit and an extra reminder was sent out, it did not have any additional impact on savings.
» Mailing reminders was not cost-effective for providers.[13]

Photo: Will Boase

IMPORTANCE OF TESTING NEW PRODUCTS

Small tweaks to product design can make a large difference. Innovations like commitment features, defaults, and reminders can help improve consumers' wellbeing and have a positive impact on the bottom line for financial service providers. At the same time, understanding the impact of any new product design feature requires rigorous testing. The Financial Inclusion Program at Innovations for Poverty Action works with service providers, governments, and researchers to design and test financial services and products to fully understand their impacts. For more information, contact financialinclusion@poverty-action.org.

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13. While using email or social media to deliver reminders hasn't been rigorously tested as far as we know, U.S. based providers may consider reaching clients through these avenues.

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