

# Behavior Changes and Prize-Linked Savings

Managing Financial Volatility



**I**nnovative financial products and services have the opportunity to improve money management habits among some of the most vulnerable consumers. One tool – prize-linked savings (PLS) – has proven popular among consumers and driven savings by rewarding savings behavior with chances to win prizes.<sup>1</sup> Save to Win (STW)™, the first PLS product in the U.S., was introduced by D2D and partners in 2009. To understand how consumers feel about the product and how it may be impacting their financial lives, D2D conducted a year-long in-depth consumer study which revealed surprising findings, including details on the unexpected role that PLS can play in helping financially vulnerable consumers manage volatility and uncertainty. This paper will explore some of these findings through a series of consumer stories. As the stories illustrate, PLS accounts can be anchors of stability, fostering choices and actions that promote financial security and diminish the feeling of vulnerability.

## Financial volatility

There is emerging awareness that a key driver of financial vulnerability is the volatility – or, significant dips and spikes in income and spending – experienced by many Americans today. Financial volatility is an obstacle to sound money management, from saving for retirement to controlling every-day spending. An analysis of income and consumption among 2.5 million JP Morgan Chase account holders shows that individuals experience high levels of income volatility and higher levels of consumption volatility across the income spectrum, and that the typical household does not have a financial buffer sufficient to weather the levels of volatility observed.<sup>2</sup> However, despite the common experience of financial volatility, the U.S. Financial Diaries Project finds that volatility is greatest among poor households.<sup>3</sup> With minimal emergen-

cy savings, limited access to insurance or affordable credit, and limited ability to adjust consumption on a moment's notice, low-income households are constantly dealing with the stress of finding alternative ways to weather income and consumption volatility.<sup>4</sup> In the absence of liquid emergency savings, low-income households often resort to costly alternative financial services, like payday loans, or make deliberate decisions --such as not paying bills on time in order to accommodate consumption needs --that damage their credit profiles and extend financial strains. This study suggests that PLS accounts can reconnect financially vulnerable consumers to the financial mainstream by helping them gain increased access to savings, affordable credit, and consumption smoothing tactics to better manage financial volatility.

## The faces of financial volatility

D2D conducted an in-depth study in Greensboro, NC, engaging with eight individuals for a year to understand their financial lives: income and spending, financial ups and downs, and how the STW product available at the Greensboro Municipal Credit Union – a year-long Shared Certificate of Deposit (CD) with restrictions on withdrawals paired with entries for a monthly prize drawing – impacted their financial behavior. Quarterly in-depth interviews and surveys yielded both qualitative and quantitative information.

D2D found that the individuals who actively used STW accounts experienced positive changes in their ability to manage financial volatility; however, the specific ways in which their behaviors and attitudes changed after using the product varied. The STW account was a catalyst for more concerted efforts to save and build financial emergency funds, it helped consumers become more mindful about the way they were managing their finances, and it encouraged expanded use of a range of financial products and services.

## Building a reliable reserve

A single mother with big dreams and a tight budget, Julia<sup>5</sup> consistently faced financial volatility due to unsteady work hours, the fluctuating monthly

<sup>1</sup> The STW product has impacted the lives of financially vulnerable consumers in a number of ways: inspiring the use of committed savings products, building a habit of savings, developing financial self-efficacy, and creating a financial cushion. See Hahnel, Amanda. Prize-Linked Savings: Creating Financial Confidence and Opportunity. Rep. Doorways to Dreams Fund, Feb. 2015. Web.

<sup>2</sup> Farrel, Diana, and Fiona Greig. Weathering Volatility. Rep. JP Morgan Chase Institute, May 2015. Web.

<sup>3</sup> Hannagan, Anthony, and Jonathan Morduch. Income Gains and Month-to-Month Income Volatility: Household Evidence from the US Financial Diaries. Working paper. The U.S. Financial Diaries Project, 16 Mar. 2015. Web.

<sup>4</sup> Farrel, Greig. Weathering Volatility.

<sup>5</sup> The names of all study participants referenced have been changed to protect their identity.

spending needs of her daughter, and occasional financial emergencies. Before opening her STW account in October of 2013, Julia had been making a concerted effort to save for a few years but she found it consistently challenging to keep a positive savings balance. She resorted to credit cards and personal lines of credit to manage volatility, accumulating debt on top of student loans. After losing her job in 2011, she did not want to take on more credit card debt, but having little savings made it her only option.

When she first opened her STW account, Julia hoped to save enough money to fulfill her dream of becoming a homeowner. Despite the volatile nature of her financial life, Julia was able to make a \$25 monthly deposit (the minimum amount that earns STW account holders an entry into the monthly drawings) into her STW account a part of her financial routine. Seeing herself save successfully through financial dips and spikes spurred Julia to increase her monthly deposit goal to \$50-\$100 just a few months after opening her account:

***"[Save to Win] has really given me an opportunity to have somewhere to start. ... It makes me really say 'there is a place for my money and there is somewhere I can save it and there is someplace I can do it on a consistent basis.' It really has given me a foundation ... and even if you are financially savvy or financially ignorant, it still gives you somewhere to start saving and saying 'oh, well you know, from here I can do much more.'"***

The account provided Julia with the challenge and the encouragement she needed to explore new ways of saving more effectively. By the end of the study period, she had built a \$500 emergency cash reserve at home, paid down a significant amount of her debt, used her accumulated STW savings to manage an emergency expense (an unexpectedly high tax bill), and saved enough to afford a down payment on a home.

Julia had been motivated to save in the past but had not interacted with a product that challenged and engaged her enough to accumulate savings. The \$25 minimum deposit of the STW account was low enough for Julia to feel confident about trying a committed savings product, while the prizes encouraged her to continuously save. STW increased

her financial self-efficacy and confidence and put her on a more certain path towards financial security.

### **Enhancing financial mindfulness**

When the D2D team met Martha, a police officer in her mid-30s, she had been tracking and managing her spending for years. Nonetheless, she had accumulated over \$100,000 in debt from medical bills, her husband's education loans, and unexpected expenses. Martha had been saving over 10% of her payroll for retirement, yet she had no emergency savings to weather financial volatility. Before opening her STW account, Martha heavily relied on overtime work hours, credit cards, and loans from her retirement savings to cover unexpected expenses. Although she enjoyed a secure job and a relatively steady income, her lack of short-term savings prevented her from reducing regular credit card use. The option to automatically save a portion of her income in her retirement account had made it easy to build a retirement fund over the years, but neglecting short-term savings resulted in an over-dependence on credit and an ever-growing debt balance.

When Martha first learned about the STW account, she saw it as a savings tool to try that would challenge her to build her savings. As she continuously made monthly deposits to be entered into the prize drawings, Martha realized that the account was giving her a new and more positive purpose:

***"...It just really has changed our lives. I'm much more aware of our money, where it is, how we're spending money, and where we want to be. It has completely changed my plans. It's a good change. It really made sure that we're focusing on the right things."***

Seeing her savings build over time, Martha found the motivation to be more mindful about her household's money and take steps towards improving her household's short-term financial security. Although Martha did not use her newly-accumulated STW savings during the study period, the product built up her financial confidence and inspired her to redirect some of her retirement account contributions to paying down her credit card debt and increase her available credit balance to use as a financial volatility management tool. By building short-term savings, Martha also created a reserve



that she can use the next time a financial emergency arises.

### Expanding the use of financial products

For Silvia, a married 60-year old mother of two college graduates, saving was never a strong suit. Before losing her job in 2014, she and her husband were earning over \$150,000 each year; she confessed they had never felt saving (beyond their long-term retirement savings accounts) was a priority and never had the discipline to save. When she had to manage the financial volatility caused by job loss and unexpected medical expenses, she accumulated considerable debt and made withdrawals that significantly depleted her retirement savings.

With both of her children nearing their college graduation, Silvia and her husband reconsidered their financial priorities. When she first heard about STW, she was drawn to the product by the exciting prospect of winning by saving. She opened the account with one goal in mind: to save enough money to cover three months' worth of expenses. The STW account gave her a place to start saving more deliberately and effectively. A few months after she first opened her account, Silvia was surprised to see herself effortlessly change her daily spending habits in order to meet her savings goals. Encouraged by her progress, she decided to open a separate non-restricted savings account with the specific purpose of proving to herself that she could save in a more liquid vehicle without draining her funds. Having gained momentum, Silvia opened yet another savings account during the study that automatically saved the change on all her purchases. She and her husband spoke with a financial adviser who helped them restructure their priorities and focus on repaying their debt and preparing for retirement.

At the end of the study, seeing her savings habits substantially improve, she felt confident that she could continue to take advantage of different financial products to save for both the short and long term:

***"Only now, and the inspiration truly for me was Save to Win, [have I been able] to put money aside and pretend it's not there, it's never been there, and let that money grow and give us some comfort."***

Much like Martha and Julia, watching herself save successfully for the first time increased Silvia's financial self-efficacy and confidence. Her change in attitude towards savings and personal finance resulted in her household taking important steps to be better prepared for financial emergencies and retirement.

### Prize-linked savings products make a difference

The stories of Greensboro Municipal Credit Union consumers allow us to better understand the different ways in which PLS products impact the lives of financially vulnerable Americans beyond simply building savings. Households managing constrained incomes, highly volatile expenses, job insecurity and fluctuating pay, and inescapable financial emergencies are able to find motivation and encouragement to reevaluate their financial lives and begin their journey towards a more secure financial future with the right tools to manage financial fluctuations.

The traction that PLS products have achieved among credit union members across the nation over the last six years makes it clear that the appeal of these products is powerful enough to get consumers to save. Consistent engagement from account holders and high roll-over rates are further evidence that consumers are using the products to develop and strengthen savings habits.<sup>6</sup>

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<sup>6</sup> Barnes, Jerome, and Andrea Vasquez. Save to Win Impact: 2014 Overview. Rep. Doorways to Dreams Fund, Sept. 2015. Web.