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Increasing Savable Funds Through Debt Refinancing

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Commonwealth is a national nonprofit building financial security and opportunity for financially vulnerable people through innovation and partnerships. Black, Latinx, and female-led households disproportionately experience financial insecurity due in large part to longstanding, systemic racism and gender discrimination. Addressing these issues is critical to Commonwealth's work of making wealth possible for all. For nearly two decades, Commonwealth has designed effective innovations, products, and policies enabling over 1 million people to accumulate more than $4 billion in savings. Commonwealth understands that broad changes require market players to act. That's why we collaborate with consumers, the financial services industry, employers, policymakers, and mission-driven organizations. The solutions we build are grounded in real life, based on our deep understanding of people who are financially vulnerable and how businesses can best serve them. To learn more, visit us at www.buildcommonwealth.org.

HEBREW FREE LOAN SOCIETY
SINCE 1892
IMPROVING LIVES THROUGH LENDING

The Hebrew Free Loan Society (HFLS) fosters financial stability and opportunity by providing access to safe and affordable credit in the form of interest-free loans. HFLS loans enable borrowers to attend college, improve their job skills, start a business, or respond to unexpected financial challenges. HFLS is a non-sectarian lender, serving the New York City area since 1892.

MetLife Foundation

At MetLife Foundation, we are committed to expanding opportunities for low- and moderate-income people around the world. We partner with nonprofit organizations and social enterprises to create financial health solutions and build stronger communities, while engaging MetLife employee volunteers to help drive impact. MetLife Foundation was established in 1976 to continue MetLife's long tradition of corporate contributions and community involvement. From its founding through the end of 2020, MetLife Foundation provided more than $900 million in grants and $87 million in program-related investments to make a positive impact in the communities where MetLife operates. Our financial health work has reached more than 17.2 million low- and moderate-income individuals in 42 countries. To learn more about MetLife Foundation, visit metlife.com.

MetLife Foundation's Financial Opportunity Project

Decades of research points to the material, psychological, and social value of wealth. Yet, building financial security is a persistent challenge for lower-income Americans, who continue to become less wealthy, not more. In fact, nearly 40% of people in the United States cannot cover an unexpected $400 emergency expense, according to the Federal Reserve. MetLife Foundation's Financial Opportunity Project aims to reverse this trend. **The four-year initiative, implemented by Commonwealth with the generous support of MetLife Foundation,** will uncover and highlight new consumer insights and pilot practices to enable wealth creation for millions of low-income individuals and families over time.

In 2021, Hebrew Free Loan Society provided approximately 200 of their existing borrowers with the opportunity to reduce their monthly repayment amount by half while doubling the repayment period, freeing up additional funds in their monthly budgets that would normally have gone toward debt repayment.

Among this group, average payments were reduced from $268 to $134 a month and the average number of remaining payments increased from 17 to 34.

Our findings demonstrated that this debt payment reduction increases some borrowers' ability to save and generally improves a feeling of increased financial wellness for most.

Emergency savings is a fundamental part of financial security and long-term wealth building for all households. Research shows that a savings buffer of even a few hundred dollars more clearly reduces the likelihood of a household experiencing financial hardship due to income or expense shocks. However, millions of low- and moderate-income Americans are consistently unable to accumulate even a small amount of emergency savings. As many as one in four American households has no emergency savings at all, according to one recent survey.

One path to increasing emergency savings for these households is through increasing the availability of savable funds (money that is available for saving) by reducing fees, expenses, and the budgetary footprint of existing debt. Savable funds is one of Commonwealth's areas of strategic focus, yielding actionable insights into how *savable* funds can become *saved* funds. This brief provides an overview of what we have learned from past savable funds research and presents results from our most recent collaboration, investigating the impact of debt payment reduction and repayment extension on savings opportunities.

About the Research

Commonwealth recently completed research into the effects of loan payment reduction and repayment extension on savable funds in partnership with the Hebrew Free Loan Society (HFLS), which provides zero-interest loans to lower-income New Yorkers, many of whom are immigrants. In 2021, HFLS provided approximately 200 of their existing borrowers with the opportunity to reduce their monthly repayment amount by half while doubling the repayment period, freeing up additional funds in their monthly budgets that would normally have gone toward debt repayment. Among this group, average payments were reduced from $268 to $134 a month and the average number of remaining payments increased from 17 to 34.

To learn more about the impact of reduced debt payments on savings and overall financial wellbeing, Commonwealth researchers surveyed and interviewed HFLS borrowers, engaging the 200 people who refinanced their loans as well as a control group of about 50 borrowers who were not interested in the offer or who were interested but not randomly selected for the refinancing. For selected borrowers, monthly payments were halved beginning in January 2021. Between January and November 2021, HFLS borrowers filled out baseline and endline surveys; those receiving the payment reduction filled out a midpoint survey in May, and nine individuals were interviewed by Commonwealth researchers in July 2021. Commonwealth also received de-identified data from HFLS on the repayment behavior of these borrowers and the overall pool of HFLS borrowers. Borrowers self-reported race/ethnicity as 57% white, 14% Hispanic/Latinx, and 11% Black.

In examining the relationship between savings and debt for low- and moderate-income Americans, we see the continued importance of reducing material barriers to saving, as well as increasing sources of savings that have positive associations, such as those freed up in ways that demonstrate trust in and respect for borrowers. This work builds on our prior research into how freeing up savable funds can be translated into consistent saving behavior, as well as Commonwealth's research in 2021 with a student loan fintech to understand the effects of the federal loan payment pause on borrowers' financial situations.

Four primary insights emerge from the HFLS research, contributing to a more robust understanding of how savable funds may become savings:

1. **Debt payment reduction increases borrowers' ability to save.** The number of people who reported that they were saving regularly nearly doubled over the course of the pilot, from 7% to 13% of respondents, compared with no change for the control group.
2. **Debt refinancing increases financial wellbeing.** In fact, 68% of respondents who received a loan payment reduction reported that their financial situation improved in the months that followed, with 82% citing the HFLS loan refinancing as contributing to this improvement.
3. **Debt with favorable terms helps reduce the burden of other, more onerous debt.** Paying down other debt was one of the primary reasons borrowers reported taking out a loan from HFLS. At the end of the pilot period, half reported that they had used the money freed up by the payment reduction to pay down other debts.
4. **Refinancing debt repayment on more favorable terms increased the likelihood of repayment in full and on time.** Participants also indicated that they would be interested in payment reduction programs like this at their regular financial institution, and that their availability would make them more interested in their financial institution's other product offerings. These results suggest that favorable debt refinancing may benefit not just borrowers, but also lenders.

In the following section, we discuss the framework for savable funds developed through prior research as context before discussing the four primary study insights in more detail.

Savable Funds Framework: Mindset, Materiality, and Mechanism

MINDSET

Debt refinancing, when done well, can be a source of positive feelings and open new possibilities for translating savable funds to saved funds. HFLS borrowers pointed to several key aspects of their experience with the personal loan, including:

- Feeling mutual respect and trust throughout the application, approval, and repayment process;
- Feeling seen and cared about when receiving the reduction offer; and
- Feeling agency to best decide how to use the additional funds themselves after the payment reduction began.

> **"The very fact that I was asked if I needed help and the subsequent offer to help have signaled to me that there was somebody there who cared. I think the importance of the latter should not be underestimated."**
> - Male borrower, age 44, $125 monthly payment reduction

These results align with past Commonwealth research examining how financial benefits provided in a way that demonstrates trust in recipients builds positive feelings and reciprocal trust from them. HFLS offered the monthly payment reduction without suggesting what to do with the funds; despite the lack of a prompt, 62% of borrowers reported making a plan and carrying it out.

Commonwealth's past work has also found that the associations existing for a source of "extra" funds can affect the possible uses considered for these funds. For example, negative attitudes toward overdraft fees–which amount to $12B per year with 95% paid by financially coping and vulnerable households–may reduce the degree to which people think of putting reimbursed or prevented fees towards other uses such as savings. In our most recent research with HFLS, on the other hand, borrowers had very positive associations with HFLS and the funds made available by the loan payment reduction; survey and interview data also showed an increase in savings behavior, discussed below.

> **"It definitely gave me some peace of mind to know that there's more income that I can work with and I could have that decision-making power to allocate my income… That was really empowering, to know that I would have more of an ability to allocate those funds."**
> - Female borrower, age 28, $125 monthly payment reduction, on changes after the first payment reduction

MATERIALITY

Our work with HFLS supports past findings that the amount of extra funds needed to be considered savable funds is not necessarily a set dollar amount, but determined based on one's unique financial situation and overall financial security. From the average monthly payment reduction of $134, HFLS borrowers reported feeling better about their financial situation and using the freed-up funds to reduce other debts and get on top of housing and other household expenses. In endline surveys, 59% of reduced payment borrowers reported wanting to save but not being able to at the time, while 23% were able to save regularly or irregularly, suggesting that the reduction opportunity moved many people closer to being in a position to put funds toward savings in the future.

The impact on the percentage of borrowers who were able to save regularly was significant—nearly doubling from 7% to 13%."

Our prior research on savable funds identified perceptions of whether newly available funds are "enough" to be worth saving as a key barrier to translating savable funds into savings. While the fundamental material barrier for many is simply that any additional funds are needed to cover necessary basic expenses, for households that can afford to save some of their income, these perceptions can have a significant financial impact in the long term.

MECHANISM

Our work has identified the availability of a savings mechanism with which consumers can easily or automatically direct even relatively small amounts of money into savings as a key path to overcoming the material and mindset barriers identified above. Given HFLS research findings showing that the payment reduction increased the likelihood of making monthly payments on time, that borrowers would be more interested in other financial products offered by lenders like HFLS, and that there is interest in saving, we see ongoing opportunities to link debt refinancing payments to savings actions.

Debt Refinancing and Savings Behavior

Survey data indicates that the inability to accumulate any savings remains a significant issue for a large percentage of the low- to moderate-income participants in this research. Before the loan reduction, 59% of HFLS borrowers reported that they were not able to save money but would like to. By the end of the research period, 52% still lacked room in their budget for savings.

While the payment reduction alone was not enough for most borrowers to begin saving, the impact on the percentage of borrowers who were able to save regularly was significant–nearly doubling from 7% to 13%. At the same time, the number who reported saving irregularly dropped from 13% to 10%, suggesting that the loan refinancing made it possible for irregular savers to save more regularly. A control group of HFLS loan recipients who did not receive the payment reduction had no change in regular savings behavior over the same period of time.

> **"I have been able to keep some money in my savings account for the first time in a very long time. I suspect it will not be long until I have an extra month's rent on hand should I ever need it."**
>
> - Female borrower, age 47, $150 monthly payment reduction, on impacts after five months' reduction

Overall, these results suggest that borrowers allocate the funds freed up by debt refinancing to savings when they are close to being able to save already. But as we will see below, these additional funds are commonly absorbed by regular expenses and payments on existing higher-interest debt.

Debt Refinancing and Financial Wellbeing

Regardless of whether the funds freed up by the payment reduction helped with savings, debt, repayment, or regular expenses, the positive impacts on financial security were clear: 18% of participants reported that their financial situation became significantly better in the months after receiving the loan, while 50% reported that it became slightly better. Notably, 82% credited the HFLS loan reduction with playing a role in this improvement.

68% of participants reported that their financial situation became slightly better (50%) or significantly better (18%) in the months after receiving the loan

Of those, 82% credited the HFLS loan reduction with playing a role in this improvement

> **"[The loan payment reduction] has helped me tremendously to allocate funds and have the head space to think of opportunities that can put my life back in an upward trajectory since Covid."**
> - Female borrower, age 45, $150 monthly payment reduction, on impacts after five months' reduction

Favorable Debt Replaces Onerous Debt

For most borrowers, the need to pay for regular expenses and existing debt prevented them from having space in their budget for saving. When asked to rate their prioritization of savings compared to paying down debt on a 0-10 scale (when holding debt), borrowers averaged a 7.5 rating; this relative emphasis on paying down debt before putting funds towards savings has been echoed in past Commonwealth consumer research.

The top three reasons HFLS borrowers reported seeking a loan from HFLS were rent/housing expenses, paying off existing debt, and managing regular non-housing expenses. These anticipated uses of the loan matched the reported actual uses at the end of the research period.

Half of survey respondents reported that they had credit card debt, making it the most common type of unsecured short-term debt for this group. The high interest rate on this type of debt makes it particularly onerous for low- to moderate-income borrowers.

One of the key ways in which the payment reduction through HFLS contributed to financial security was by allowing borrowers to use the funds freed up to reduce the burden of more onerous forms of debt like credit cards. In fact, 86% of survey respondents agreed or strongly agreed that the payment reduction made it easier for them to pay down their other debts.

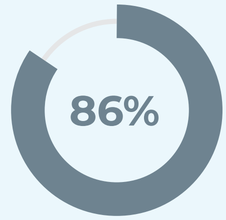
Business Benefits of Debt Payment Reduction

In addition to the financial benefits of debt refinancing for low- to moderate-income borrowers, this research suggests that there is also a business case for providing people with the opportunity to reduce monthly debt payments and extend the length of repayment.

The first way in which more favorable payment plans may benefit lenders is through increased repayment rates. Most respondents (86%) agreed or strongly agreed that the loan payment reduction increased the likelihood they would make payments on time, while 77% agreed or strongly agreed that the reduction increased the likelihood of paying back the full loan amount over time.

Offering loan refinancing may also contribute to customer interest and loyalty. The overwhelming majority of participants stated that if a financial institution offered loan payment reduction opportunities they would be interested not just in those products, but also in other financial products the institution might offer.

> **Offering loan refinancing may also contribute to customer interest and loyalty.**



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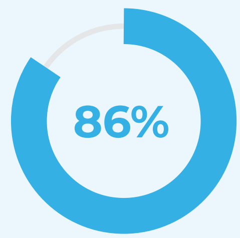
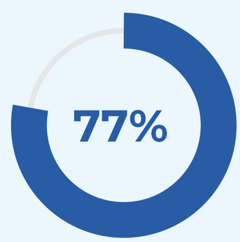


86% agreed or strongly agreed that the loan payment reduction increased the likelihood they would make payments on time



77% agreed or strongly agreed that the reduction increased the likelihood of paying back the full loan amount over time

Conclusion

This pilot provides further support for the idea that finding ways to free up additional funds in the monthly budgets of low- to moderate-income households increases their ability to save more regularly. However, it also highlights the difficulty of saving for many who are burdened by existing high-interest debt. For these households, this research suggests that more favorable credit options with lower interest rates and longer repayment periods allow people to replace onerous debt with more manageable debt, increasing financial wellbeing and bringing them closer to being able to save consistently.

> **"I am seeing and exercising more options which may benefit me and my family financially, and being able to make my payments without worry or pressure on my guarantors means a great deal to me."**
>
> - Male borrower, age 61, $150 monthly payment reduction, on impacts after five months' reduction

For lenders, this research sheds light on the ways that more generous refinancing on loans may increase customer interest and financial stability, potentially increasing repayment rates in the long term by allowing borrowers to build a savings buffer that shields them from financial shocks.

Commonwealth will continue to explore opportunities for creating savable funds in the budgets of low- to moderate-income households. Stay tuned for more research into the benefits of facilitating savings for both consumers and financial institutions.

We are actively engaging with innovators, fintechs, financial services firms, industry experts, employers, and policymakers. To learn more about how your organization can partner with us to discover new data, receive expert insights, and strategize to improve financial security and opportunity, contact Becca Smith, Commonwealth Senior Innovation Manager or sign up for our newsletter. We look forward to working together towards a more equitable financial future for people living on low- to moderate-incomes.