Saving in lower-income households: A review of the evidence
Summary

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The promotion of saving has been the subject of Government activity for a number of years. When the Financial Inclusion Taskforce was re-appointed for a second three-year period in 2008, its terms of reference were extended to cover savings. This study was carried out to provide an overview of the existing evidence on non-retirement saving among lower-income households and is intended to help the Taskforce identify the potential for increasing levels of saving among these groups and improving take-up of saving products from regulated providers. The findings are based on a review of the literature and secondary analysis of two existing data sources: the Baseline Survey of Saving for and by Children (BSSC); and the first pilot of the Saving Gateway, a government supported cash saving scheme for people on low incomes and of working age.

Patterns of saving

Most people on lower incomes save in some form, albeit sporadically and in small amounts. There is, however, a heavy reliance on informal saving methods, such as saving cash at home and buying saving stamps.

The reasons for saving among people on lower incomes tend to fall into two broad categories: saving for a specific, typically short-term purpose or anticipated expense; and saving to provide a financial safety net. Although many people with low incomes aspire to saving towards longer-term needs, such as for their children's future needs, more immediate priorities mean that few do so in practice.

Regardless of income level, people tend to approach saving in a way that is consistent with a deep-seated disposition. *Rainy day* savers are the most committed types of savers, who save actively and most regularly and with no specific purpose in mind, instead seeing saving as a priority in itself. This approach normally starts in childhood and becomes a self-reinforcing habit throughout adulthood.

Instrumental savers – who represent a large and diverse group – find it difficult to save without a specific goal in mind and consequently cycle through phases of saving and spending. As a result they often have no savings at all or only small amounts saved. Instrumental savers tend to be people who have only started to save as a teenager or as an adult. Meanwhile, the small minority who are *non-savers* see little reason – practical or psychological – to save.

Many non-savers become instrumental savers with time. Moreover there is evidence that, with the right incentives, some non-savers and especially instrumental savers can convert to rainy day savers.

Levels of saving account-holding

Analysis of the BSSC shows that lower-income families were less likely to have a saving account (53 per cent) compared with better-off families (82 per cent). At all income levels, having any money saved in an account was much less common than account holding: fewer than one in five (18 per cent) of all lower-income families had any money saved formally.

Lower-income families who were renting their home, particularly if renting from a social landlord, one-parent families, and those in which one or both householders were not working were at increased risk of saving account exclusion, other things (including income) being equal.

People of Asian or Asian British origin were less likely than other groups to have a formal saving account, even after accounting for other characteristics. Remitting money abroad and a preference for alternative forms of financial provision (such as investing in property, micro-business and gold) help to explain the low rates of saving among some minority ethnic (and migrant) groups.

Lacking a current account was also independently linked with increased likelihood of lacking a saving account among lower-income families although the effect was not strong.

Somewhat different factors related to having no money saved in an account. Living in Scotland, Wales, and especially Northern Ireland and having no unsecured borrowing or large amounts in borrowing increased the likelihood of lacking formal savings independently of other factors.

Nonetheless, attitudinal characteristics were important drivers of being without a saving account and being without any formal savings, as was reporting never or hardly ever having money left over at the end of the week or month. The research additionally suggests that having an unstable income is important for understanding saving exclusion, over and above the effect of having a low income.

Active saving and the attractions of saving informally

The likelihood of saving actively into an account was also far lower among lower-income families (37 per cent) than those who were better off (66 per cent).

When informal saving was taken into account, the difference between the proportions of lower-income and better-off families who were saving narrowed considerably. Thirty-eight per cent of lower-income families were *only* saving informally, compared with 21 per cent of better-off families.

The attractions of saving informally identified in research include the ability to save small and varying amounts conveniently, as and when people could afford to do so and the ability to save directly towards a particular purpose. Socio-cultural factors, such as an existing tradition or culture of use of particular alternative providers, trust and familiarity with individual organisations, and the potential for some schemes to fulfil a social function, also played a role.

Not saving at all and how to shift priorities

Nevertheless, families with lower incomes were still more likely (25 per cent) than better-off families (12 per cent) to not be saving actively in any way, not even informally.

The inability to save due to a low – or unpredictable – disposable income is generally considered the main reason for not saving at all, including by individuals themselves. However, a lack of money does not fully explain why so many people do not save. Instead, it is important to distinguish between being unable to save due to a lack of money and being unable to save due to having other priorities.

This raises the question of what can be done to encourage people to shift their priorities. Since patterns of saving are set early in life initiatives that encourage children to save have particular value. Some providers offer special accounts for children and some third sector organisations work with schools to provide saving clubs. Both are initiatives that the Taskforce may wish to promote. Experience with the Saving Gateway shows that adult non-savers can be encouraged to save with the right account and if the reward is high enough. Moreover, once they had started to save many Saving Gateway participants continued to do so at the end of the life of the account.

Barriers to saving formally and how they may be overcome

Overall, the existing evidence base provides a good understanding of the factors that inhibit and incentivise saving formally among people on lower incomes.

Compared with other areas of financial services, there are no major structural failures in the supply of saving accounts. Where failures do exist, these reflect a mis-match between what people on lower incomes want or need and the products and services that are available. The study has identified three 'meta-barriers' to saving formally where the supply barriers interact with and reinforce the demand barriers. These relate to 'access', 'knowledge and understanding' and the 'attractiveness of formal products'.

While the evidence shows that the Saving Gateway has the potential to overcome many of the barriers identified, the findings suggest other actions that the Taskforce may wish to explore.

Access

Local branch closures not only create a geographical and cost barrier to the use of their services but create an even greater psychological one. People on low incomes or from a Black and ethnic minority background mistrust commercial providers who they believe are neither interested in nor understand their needs. This is reinforced by the application of identity checks and the behaviour of a minority of staff.

The evidence shows that trusted providers with a local presence can play a role in overcoming both physical and psychological access problems. Experience from the two Saving Gateway pilots shows the importance of trusted intermediaries in helping people overcome psychological barriers.

The Taskforce may, therefore, wish to promote the availability of the Saving Gateway through the Post Office and credit unions and also to encourage saving through third sector organisations alongside loans from the Growth Fund. Financial Inclusion Champions also have an important role to play in encouraging intermediary organisations to support people who may wish to save formally but are fearful of approaching a provider or who encounter difficulties with account-opening.

Knowledge and understanding

The complexity of financial products generally, combined with people's lack of experience and understanding, deters them from using formal saving products. This is compounded by a lack of products with a simple expression of returns and a paucity of easy-to-read product information.

Rather than try to educate people to deal with inappropriate complexity, the most effective way of tackling a lack of knowledge of saving accounts is to try and remove the barriers. The provision of easy to understand accounts has been shown to be the most important factor for encouraging people on the very lowest incomes to open an account. The simplicity of matched saving and bonus payments means they have a far greater effect than interest rates or other financial incentives.

People on low incomes also need clear information about accounts that is easily accessible. Trusted intermediaries have an important role to play as a source of information and advice.

In promoting saving generally and through third sector organisations, the Taskforce should bear in mind the need for simple accounts that are accompanied by easy-to-read information. The Financial Inclusion Champions can also encourage intermediary organisations to provide information and help to people on low incomes who may want to open a saving account.

Attractiveness of formal products

The design of formal saving accounts means they are less attractive to people on lower incomes than informal and alternative methods of saving. The returns on a conventional saving account are insufficient to counteract this or to encourage people not to spend.

In general, the rate of return is the most important incentive for account opening among people on lower incomes and also for saving into it. The Saving Gateway has recognised this fact and will be offering 50 pence matching for every pound that is saved. A lower match rate is likely to be insufficient to convince non-savers to start saving.

It is clear that people save in different ways for different purposes. Among those on low incomes, formal saving accounts are thought to be primarily for rainy day saving. They often save up informally for known expenditure; this is the reason why Christmas saving schemes have been so attractive. Some building societies and credit unions are now offering Christmas saving accounts.

Some people also choose to save informally because they like to be able to see their savings mount up. A saving account that caters for people on low incomes does, therefore, need to have a passbook or something similar for it to have the same attraction.

There is also a general preference among people on low incomes for accounts that incentivise them not to make withdrawals but allow easy access in an emergency without too great a penalty. The exception is accounts where the money is being saved for a particular purpose, when they may prefer not to be able to access the money at all until a pre-determined date.

The Taskforce may wish to promote the development of successor accounts to the Saving Gateway which, though not able to offer such generous returns, have the key attributes that encourage people to retain the savings they have accrued and which continue to reinforce the saving habit.

Encouraging longer-term and regular saving

Finally, whether people save formally or informally, the most common pattern is saving to spend. A key challenge is, therefore, to find ways of encouraging people to extend their saving horizons and to begin saving for non-specific reasons (such as rainy day saving).

Rainy day savers are ‘born’ at a very early age and retain that aspiration for life. This argues for encouraging saving at a very young age through, for example, financial education initiatives that help students learn the importance of saving and other money management issues.

Among adults, the factors that encourage regular and longer-term saving include establishing realistic saving targets and a routine for making deposits so that the money saved is not missed. Again, incentives to retain the money in the account encourage people not to withdraw the money saved.