

THE BRICKS' SAVINGS ACCOUNT

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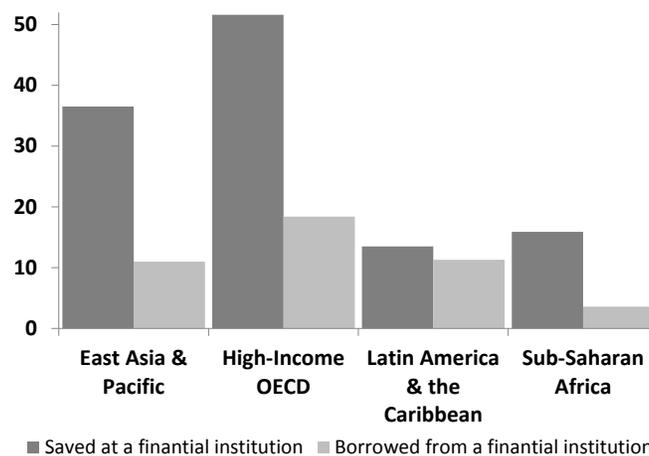
“Caja Ladrillo” (The Bricks’ Savings Account – BSA)

Combining a commitment saving account with financial and behavioral incentives to foster financial inclusion and soothe housing deficit

Elevator Pitch

The available evidence suggests that poor households face significant administrative, informational and behavioral barriers, restricting savings and access to formal financing. Existing studies also show that commitment saving accounts and reminders are effective at inducing saving. Only 14% and 16% of adults save at a financial institution in Latin American and the Caribbean and in Sub-Saharan Africa, respectively.

Figure 1. Saves and borrowings, 2014 (as % of population over 15 years old)



Source: CIPPEC, based on The World Bank Global Financial Inclusion Database (2014).

Abstract

By increasing the readiness of low-cost saving products designed to meet the need and constraints of poor people, financial institutions and policymakers can provide tools to improve welfare. CIPPEC has developed an **innovative mobile-banking tool** targeted to low-income households: a **commitment savings account combined with a credit line, attached to a goal related to housing improvement: “Caja Ladrillo” (The Brick’s Savings Account or BSA)**. The credit line must be used to purchase **construction materials**. By combining a commitment saving account with financial and behavioral incentives, **CIPPEC intends to contribute to foster financial inclusion and soothe housing deficit, and to encourage sustainable saving habits and investment in real assets among low-income populations**

1. The Problem: Financial Inclusion and Housing Deficit

Recent evidence points that **low-income households tend to save or borrow through expensive and risky financial modalities**: holding cash at home (that it is subject to theft or fire), purchasing durable goods or livestock (that may break or die) or participating in rotating savings and credit associations, who often take advantage by charging high interest rates or imposing stringent repayment conditions (Dufflo and Banerjee, 2011).

Only **14% and 16%** of adult population **save at a financial institution in Latin American and the Caribbean (LAC) and Sub-Saharan Africa (SSA)**, respectively. This number ascends to 52% for high income countries in the OECD. Meanwhile, 8% of LAC's adult population saved using a club or person outside the family. This number ascends to 24% for SSA. On the other hand, **59% of LAC's adult population and 40% of SSA's adult population did not save any money in 2013¹**.

The existing empirical evidence points to **three main culprits** to explain the presence of non-sustainable financial behaviors among low-income individuals. First, **administrative barriers**, such as strict legal requirements (e.g. property titles and guarantees) and relatively high transaction costs, discourage participation of the lowest income population in formal financial markets (Karlan et al, 2013). Second, the presence of **barriers related to financial literacy** due to lack of information or knowledge on formal saving options, strategies and benefits may prevent households from opening accounts (Brune et al, 2011). Third, **behavioral barriers** such as inattention and self-control may limit the adoption of formal credit and saving options due to an existing tendency of deprived low-income households to overestimate the benefits of present consumption at the expense of savings for future consumption (Duflo et al, 2010). Similarly, limited attention may distort inter-temporal choice in deprived set ups. Additionally, poor families seem to have significant difficulties for calculating future variable recurrent expenses (Karlan et al, 2011). Finally, a lack of self-control and social network pressure to share their incomes may discourage formal and sustainable financial behavior among the poor (Brune et al, 2011, Ashraf et al 2006 and Karlan et al, 2013).

Meanwhile, **housing problems affect more than one third of LAC's families living in cities**. Out of the 130 million urban families in the region, 3 million live in houses that are beyond repair and 34 million live in houses that lack title, water, sewerage, adequate flooring, or sufficient space². In hand with saving constrains, **only 11% of LAC's adult population was able to borrow from a financial institution in 2014³**.

¹ The World Bank Global Financial Inclusion Database (2014).

² Room for Development. Housing markets in Latin American and the Caribbean (2012).

³ The World Bank Global Financial Inclusion Database (2014).

In this context, CIPPEC devised an innovative financial tool targeted to low-income households: a **commitment savings account combined with a credit line, attached to a goal related to housing improvement**. Households will be given the opportunity to get in touch with **mobile banking**: along the saving period they will receive text messages (SMS) with reminders, motivational contents and saving strategies with the aim of mitigating the barriers that hinder sustainable financial behavior. When the saving goal is achieved, households will be given a credit line proportional to the amount saved. This credit line must be used to purchase construction materials. By combining a commitment saving account with financial and behavioral incentives, **CIPPEC intends to contribute to foster financial inclusion and soothe housing deficit, and to encourage sustainable saving habits and investment in real assets among low-income populations**.

2. The Evidence: Providing Incentives for Saving

Could financial incentives offered to low-income households, coupled with saving accounts, encourage savings habits and help them to reach a savings goal? Could reminders combined with financial incentives address biases associated with inattention and self-control and increase savings further? Existing evidence suggest that incentives for a more sustainable financial behavior among the poor could be provided by mitigating administrative and behavioral barriers.

First, a key issue for the utilization of formal financial services is account opening, or “**take-up**”. According to Goldberg (2014), take-up of saving accounts is often very high, averaging more than 80% of households offered accounts in Kenya and Nepal. Yet, other studies have found some lower take-up, like the case of Chile, where the take-up among members of a microfinance organization was 53%. These experiments reduced the information barriers and financial costs of opening accounts. A recent study by McConnell (2012) explores alternative strategies to increase take-up when offering a saving product. She finds that convenience (opening accounts from home or workplace), marketing strategies that offered products door to door, and information about the future benefits of opening the account increase take-up. As Goldberg (2014) points out, small costs can be big obstacles, especially for customers who are sometimes illiterate, lack formal identification documents, or may be uncomfortable interacting with bank officials.

At the same time, Schaner (2011) shows that **reducing transaction costs** via ATM cards induce an increase of 40% in savings and 16% in account balance. Prina (2013) offered free bank accounts to low-income families in Nepal and found that over 80% of those offered the free savings accounts opened one and used it. This number is smaller (less than 50%) in another study by Dupas and Robinson (2013) that offered to pay minimum balance and opening fees of savings accounts to informal workers in Kenya.

Meanwhile, information simplification and training aimed at reducing **literacy barriers** seems to have mixed impacts on low income households. A study by Carpena et al (2011) finds that financial literacy improves awareness about financial products and services available to them as well as their attitude towards financial decisions. Similarly, Drexler et al (2010) also find evidence on how simplified rule-of-thumb training improves financial behavior. Duflo et al (2006) find that framing and information affect saving decisions when the procedures to participate -in a matching contribution program- are simplified and people are assisted by professionals. Finally, innovative interventions using mainstream media (soap operas and radio programs) have proven to be more effective in increasing awareness of financial knowledge. Berg and Zia (2013), for example, found significant impacts on content specific financial knowledge and awareness of financial behavior from a primetime television soap opera in South Africa.

Regarding **behavioral barriers**, in their attempt to study how limited attention may distort inter-temporal choice, Karlan et al (2011) find that messages with reminders contribute to increase savings by 6% and that the effect could reach up to 16% when the text messages are focused on a specific objective or a specific future expenditure. Additionally, Dupas and Robinson (2011) conclude that financial instruments that include a commitment mechanism bring better results on financial behavior. Likewise, Ashraf et al (2006) find that Philippine households that voluntarily commit to limit the use of their funds succeed in increasing their savings by 81% after a year and sustainably. Similarly, experimental evidence provided by Brune et al (2011) shows that Malawi's small crop farmers that were offered a saving account with a commitment clause of not using the money until the next year increased significantly their savings, in contrast to those whose accounts had no commitment clause. They bring two possible explanations for this result: first, a self-control solution when there is a commitment; and second, the refrain from sharing their income with their social network.

Theoretical as well as empirical evidence argue that individuals often find commitment valuable to deal with self-control problems (Shefrin and Thaler, 1981; Karlan et al, 2013). Different strategies create commitment and have proven to improve individuals' inter-temporal decision-making. Examples of these are devices that constrain expenditures by assigning labels to specific accounts (Thaler, 1999). Labeling an account with a specific expenditure creates a commitment that contributes to solve self-control problems (Thaler, 1985; Karlan and McConell in an ongoing study in Ghana). Another experimental study finds significant increases in savings rates (25% to 35%) as a result of a commitment savings product created by labeling savings account (setting specific savings goals) and publicly announcing their savings goal to other members of the group (Salas, 2013). Designating the savings account for a specific purpose may act as a "mental accounting" device: people behave as though money is non-fungible and are more likely to use it for its designated purpose (Goldberg, 2014).

3. The Product: The Bricks' Savings Account (BSA)

The Bricks' Savings Account (BSA) consists in a commitment savings account attached to a pre-defined goal (a “dream”) of housing improvement. The goal will be supported by a budget prepared with the assistance of a financial institution's credit official that will help the saver to estimate the cost of the desired improvement in housing conditions. Once the goal is financially dimensioned, the official and the saver will agree upon the amount of money and the period of time the person commits to save in order to achieve the “dream”. The budget, the goal and the saving plan will be stated in a commitment letter the saver will sign at the beginning of the saving program. Once the account has been opened, the financial institution will send SMS with reminders, motivational contents and saving strategies. The commitment letter and the reminders are the two behavioral incentives embedded in the basic setting of the BSA. All in all, the outputs will be as follows: the adoption of the BSA and the opening of a BSA at the financial institution; the signature of the commitment letters; and, the delivery of messages to every saver.

Target households will be **door-to-door offered the BSA** by the financial institution. First, offering BSA personally will reduce transaction costs towards opening a new bank account and taking a formal loan and will also reduce the opportunity cost of saving and investing formally and safely. Second, given the few and flexible requirements to apply to a BSA account and by explaining easily how it works (even based on visual promotional materials), administrative and informational barriers will be reduced. Third, BSA will reduce transaction costs towards opening a bank account through mobile banking, that is, low income households will face the opportunity to use mobile-telephone technology to open and operate their account.

As suggested by the recent evidence reviewed above, these behavioral incentives may not be sufficient to induce a sustainable financial behavior in the presence of other barriers. Therefore, BSA will incorporate a **financial incentive** aimed at inducing the client to save a larger amount of money and for a longer period of time: a **credit line conditional to the successful completion of a pre-committed saving plan**. This credit line will also reward –with better credit conditions- those clients that save the most. The money saved during the first phase will act as collateral available for the financial institution. Credit conditions (e.g. amount, interest rate and repayment plan) will be established by the financial institution based only on the client's saving capabilities as shown in the BSA's balances. The credit line will have to be used by the saver only for the **acquisition of construction materials** required to achieve the “dream” (e.g. the desired housing solution). The money of the **credit can only be spent using a debit card in a construction material's retailer**.

The **causal chain** leading to the **expected outcomes** will be as follows. By **defining and committing to accomplish a saving goal and reminding** to make the deposit, the expected outcome is that the client will effectively recall and make the deposit when it is planned instead of

spending that amount of money in unnecessary consumption. Consequently, the client will increase her savings and invest in construction materials (as pre-defined in the “dream”). Access of unbanked low-income households to a formal financial product is another expected outcome. In turn, the **final expected outcomes** will be the **adoption of sustainable financial behavior** (which may include avoiding unnecessary expenditures), access to formal credit and investment in housing improvements. In particular, new clients with no credit history, by saving first and showing capability and willingness to save, will have access to a financial product that the banking system would not offer.

From a practitioner’s point view, the financial institution will be able to increase loans’ offering at lower rates and less stringent credit conditions by increasing saving account balances through the BSA deposits. This will facilitate that deprived households, with the willingness to save and repay credit, access to the financial system and to low-cost and safer sources of finance.

All in all, this product is the **first of its kind** due to at least three reasons. First, it is the first labeled savings account oriented to investment in real assets (e.g. housing improvements) that could contribute to preserve, and potentially increase households’ wealth and improve life conditions. Second, balances in the BSA’s savings account will work as collateral, allowing the financial institution to reduce the financial costs of credit provision, fostering financial inclusion. Third, the saving period will function as a screening mechanism for credit’s approval, improving opportunities for applicants who cannot meet the requirements of the traditional banking system.

4. What will be needed to implement the BSA?

To implement the BSA, financial support will be needed to launch a pilot to evaluate the product with a sample of clients of a large financial institution throughout a randomized control trial (RCT), and subsequently scaling it up to its entire client base.

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