New America Foundation

Asset Building Program

Incentivizing Savings at Tax Time

$aveNYC and The Saver's Bonus

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The ability to accumulate and access savings is a fundamental determinant of economic security for many families, especially those with low incomes and limited resources. Since every family's circumstance is different, so too are their savings needs, which can range both in time horizon and flexibility of use. Current federal policy favors longer-term, targeted purposes, such as savings for retirement, leaving a void in policy supports for households whose savings needs are more immediate. This impedes a household's ability to build up a stock of unrestricted savings that are accessible to buffer against financial shocks or unexpected events or to invest in ways that may improve their future, roles that serve as the underpinning for economic mobility.

Policy solutions to fill this gap need to address both the lack of resources that lower-income households can dedicate to saving and the lack of products that facilitate saving for multiple purposes. In response, the New America Foundation has developed a proposal, The Saver's Bonus, which offers lower- and middle-income households the option to open an account and an incentive to save in that account at a moment when they are receiving an influx of resources—tax time.

Through a simple and easy procedure integrated into the process of filing taxes, families can be linked to a range of savings products that are specific to their savings needs. Over the past three years, a version of The Saver's Bonus has been tested at the local level in New York City; it is now being replicated in several cities across the country. The pilot is producing results and insights that can inform a larger discussion of designing effective savings incentives for a targeted, lower-income population. This paper will present the policy rationale, review the pilot experience and its key findings to date, and explore the federal policy ramifications.

Policy Rationale

Households have a range of savings needs to help them improve their circumstances and deal with life's expected and unexpected events. Needing first and last month's rent to move into a better neighborhood, taking classes to increase professional credentials and get a better job, buying new clothes for growing children, taking time off work to care for an ailing child or parent, or getting by after job loss all require savings that families can use at their own discretion.

Without sufficient savings at these moments, families incur a cost, either in terms of their present wellbeing or future opportunities. This cost could be compounded by the long-term financial consequences of the decision to take on debt or draw down targeted investments in the absence of these resources.[1] In a 2008 survey of middle- and low-income households, thirty-seven percent reported using their credit cards to cover basic living expenses, such as rent or utilities, and were likely to be carrying a balance over $5,000 more than households who charged discretionary purchases.[2] For families already unable to pay for their basic needs, debt may bridge a short gap between what they have and what they need, but can compromise their ability to pay for it in the future, and, consequently, make taking on more debt necessary, which could account for their higher balances. In this way, debt displaces other, more productive uses of resources that allow families to move forward in their lives.

Even among higher-income earners, inadequate precautionary savings can exact financial harm into the future. As a consequence of the Great Recession, over half of working adults experienced a period of unemployment or a decrease of wages or hours. Increasingly, families have had to turn to their retirement savings to compensate for their lost income.[3] Hardship withdrawals from Fidelity administered 401(k) plans, for example, increased by almost 40 percent from 2007 to 2010, covering the period from just prior to the downturn through immediately after.[4] Not only do these withdrawals have a 10 percent penalty upfront and trigger a higher tax bill, but the Government Accountability Office found that even a modest hardship withdrawal of $5,000 could reduce the balance available at retirement from 5 to 12 percent.[5] Since households become reliant upon those resources after they leave the workforce, protecting the sources of that savings is critical for a financially-secure retirement.

While a macroeconomic shift like a recession illustrates the need that families at all income levels have for precautionary savings, the destabilizing impact that everyday occurrences can have on low-income families makes this need particularly imperative. Precautionary savings can decrease the susceptibility of low-income households to hardship in the event of an emergency, unexpected expense, or loss of income by providing an immediately available stock of resources to smooth over potential disruptions in their consumption. [6] Among families that experience a job loss or health condition that limits their ability to work, at least 40 percent of liquid-asset poor families reported increased hardship, such as food insecurity or inability to pay bills, but for families that had liquid assets, this number was below twenty 20 percent.[7]

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By intervening during a destabilizing event, precautionary savings could also serve as a firewall against subsequent, related "after-shocks." About half of all the economic shocks experienced in 2008 reoccurred in the same households in 2009 as a consequence of higher levels of unmet need.[8] A job loss, for instance, can compromise the ability to afford health insurance or medical care and result in an untreated illness that, in turn, compromises the ability to maintain work. Even an event as minor as a car breaking down could escalate to lost wages or lost employment without sufficient resources to finance the repair. Being able to access resources at a particular

[1] Lopez-Fernandini (2010).
[2] Garcia and Draut (2009).
[3] Pew Research Center (2010).
[4] Fidelity Investments (2010).
[5] GAO (2009).

[6] Acs, Loprest, and Nichols (2009).
[7] McKernan, Ratcliffe, and Vinopal (2009).
[8] Hacker, Rehm, and Schlesinger (2010).

moment in time is a characteristic that makes precautionary savings foundational to achieving economic stability in the near-term and security over the long-term.

While precautionary savings is critical to averting hardship, building resilience, and making productive investments over time, almost 68 percent of families in the bottom income quintile are classified as "liquid-asset poor" and lack the resources to subsist for three months at the official poverty line without income.[9] For 2010, this amounts to $4,400 for a family of one parent and two children.[10] However, even sums below $2,000 have been shown to significantly reduce the incidence of negative financial or material outcomes, such as missing a rent or utility payment or foregoing adequate nutrition.[11]

The choice to save, clearly, is predicated on the ability to save. When these institutional supports, such as access to an account, a direct match incentive, and facilitated deposits, are in place, however, research shows that even very low-income households can and will save and develop strategies to save.

Despite this need, low-income families encounter significant challenges when trying to save. Beyond their lack of resources to convert into savings, they also lack access to the institutional supports that facilitate and encourage saving. Low-income households are less likely, for instance, to be offered a structured savings plan through their workplace, such as a 401(k) that automatically deducts a portion of their wages into retirement savings (and often with a direct match by their employer) or be eligible for the subsidies offered for saving through preferential tax treatment of investments. Moreover, at least 17 million American adults reside in households that are unbanked and lack the most basic building block for accumulating savings: an account.[12] An additional 26 million adults are under-banked, meaning that they have a checking or savings account but rely on alternative financial services, such as payday loans or check-cashing services. The choice to save, clearly, is predicated on the ability to save. When these institutional supports, such as access to an account, a direct match incentive, and facilitated deposits, are in place, however, research shows that even very low-income households can and will save and develop strategies to save.[13]

Expanding access to these supports is necessary for building up savings and supporting the savings habit that together can promote financial security. These two actions can be mutually reinforcing. In addition to the financial benefit of saving, the experience of saving can change the way an individual conceives her future and nurtures certain attitudes, choices, and behaviors, or "asset effects," which can lead to positive outcomes, including the perpetuation of the act of saving itself.[14] Even small amounts of saving have been linked to behavioral changes.[15]

Public policy currently provides a patchwork of supports for saving to different people for different purposes and through different mechanisms. While there are several programs and federal initiatives designed to overcome institutional barriers to saving, they are small in scale and modest in their impact.[16] In contrast, hundreds of billions of dollars a year are allocated through the tax code to

[9] Ratcliffe and Vinopal (2009).
[10] U.S. Census Bureau (2010).
[11] Mills and Amick (2010); Brobeck (2008).

[12] FDIC (2009).
[13] Sherraden, Schreiner, and Beverly (2003); Beverly, Moore, and Schreiner (2001).
[14] Yadama and Sherraden (1996).
[15] Sherraden, McBride, and Beverly (2010).
[16] Cramer, Huelsman, King, Lopez-Fernandini, and Newville (2010). For FY2011, $50 million was requested to support the Bank On USA initiative to expand access to basic financial services in underserved communities and $24 million was requested to support the Assets for Independence Act to provide matched savings accounts for low-income participants. Meanwhile, over $340 billion was allocated through tax expenditures to support homeownership and retirement security.

subsidize saving for college, retirement, and homeownership. While this approach achieves a much larger scale, both in terms of resources deployed and households reached, most low-income families lack sufficient tax liability to be eligible for these benefits. As a result, the primary system for incentivizing saving is inaccessible to households most in need of savings and with the most difficulty accumulating them. What is missing from current policy mechanisms, administered through the tax code or otherwise, is an accessible platform with meaningful incentives to support precautionary savings needed by all families.

The role that asset-based interventions play to support the economic advancement of low-income families has increasingly informed how social policy is conceived and delivered in other parts of the world. In response to a similarly regressive distribution of savings incentives for longer-term goals administered through their tax system, the UK launched the Saving Gateway, an initiative to build unrestricted savings among low-income households by offering a match incentive.[17] In this large-scale pilot, when participants contributed to a designated savings account, additional deposits were made to their accounts by program sponsors. Although the match rate varied (ranging from £.20:£1 to £1:£1), the pilot generated evidence that participants responded positively to the incentive structure of the direct match.

At the conclusion of the pilot, more than half of all participants saved the maximum met by the match, 65 percent of participants who reached the match limit continued to save into their account, and just as significantly, participants experienced an increased attitude toward savings and sense of security.[18] As the Saving Gateway experience shows, constructing savings policy around appropriate institutional supports can create an entry point to saving, even for households with limited means and little or no previous saving experience.

[17] Sodah and Lister (2006).
[18] Cramer (2007).

The Tax Time Moment

Families that would greatly benefit from increased savings are missed by the current incentives delivered through the tax code. They are, however, captured by the tax filing process itself. Both the number of families that engage in this process and the significance of the resources they receive make the tax time moment a powerful savings opportunity.

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This tax season, around 26 million households are likely to file for the Earned Income Tax Credit, a credit that boosts the value of work for low-wage earners by offering an additional subsidy for every dollar in earned income. In 2010, the average value of the EITC was $2,216 per household with a potential maximum of $5,666.[19] Households with children could also be eligible to receive an additional $1,000 per child through the Child Tax Credit. For many households, their tax refund may be the largest lump sum of cash they receive all year. As part of the American Recovery and Reinvestment Act passed in 2009, both the EITC and Child Tax Credit were made more generous for families claiming those benefits. A parent working full time at minimum wage with two children, for example, would see a boost of around $1,500 in her tax refund. Although the expansions in these programs were temporary, they have been extended through 2012.

These cash infusions can be used to cover everyday expenses and bills but may also be directed toward meeting other savings objectives. This makes tax time a valuable and large-scale opportunity to promote saving and asset building. Policymakers have recently implemented a series

[19] IRS (2010).

of changes to the tax filing process which recognize this moment, including amending tax filing forms to allow tax filers to split their refund in up to three accounts as opposed to requiring receipt in a lump sum, and offering the opportunity to purchase U.S. Savings Bonds with tax refunds. Still, it is a moment policymakers should strive to leverage further.

Over the past three years, the City of New York has been testing this concept of saving for precautionary purposes as seeding the savings and savings behavior necessary to advance to saving for longer-term, targeted purposes. The pilot, $aveNYC, puts The Saver's Bonus into practice and presents insights into bringing this proposal to a national scale.

In this spirit, the New America Foundation has developed the concept of a Saver's Bonus delivered at tax time that would provide a direct match to deposits made by families to a range of savings products. A legislative version of this idea was proposed by Senator Robert Menendez (D-NJ); the Saver's Bonus Act would provide a 1:1 match up to $500 for low-income households that make deposits into a range of savings products, including those associated with retirement, college saving, and others with fewer restrictions, such as savings bonds and short term certificate of deposit accounts.[20] The Saver's Bonus would be available to low- and moderate-income households, those with incomes below approximately $46,000. These households need greater assistance saving given their lower incomes and are the ones most likely to see the largest benefits.

The Saver's Bonus proposal offers several unique features that would create a pathway for households with little or no experience saving to start the savings habit and advance up the economic ladder. First, by offering a larger array of savings options, households will have the flexibility to save for the purpose that best fits their needs, which should increase the likelihood that they will make the choice to save. The inclusion of incentives to save for short-term, unrestricted uses, in particular, presents an accessible entry point for households that struggle to make ends meet. By helping families satisfy their short-term needs and attain financial stability through building a stock of precautionary savings, The Saver's Bonus would make the prospect of saving for retirement or college more realistic and accessible.

If tax filers do not already have an account, The Saver's Bonus would allow them to use their tax refund to open a new account directly on the federal income tax form. This feature is particularly important for the population who would be eligible for The Saver's Bonus since they are less likely to have a preexisting account. Only 17 percent of households in the lowest income quartile, for instance, participate in an employer-sponsored, 401(k) style retirement plan.[21] Accordingly, The Saver's Bonus would facilitate the entry of new savers into the marketplace by making it easier to start the savings habit.

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The New York City Pilot Experience

In 2008, the New York Department of Consumer Affairs Office of Financial Empowerment (OFE) launched $aveNYC to test over three consecutive tax seasons the

[20] Cramer (2010).

[21] Purcell, Patrick and John Topoleski (2009).

potential of facilitated account opening and a direct match incentive for increasing savings among low-income households at tax time. Funded privately, the program offered a 50 percent match on deposits made into an eligible account from their tax refund. Accounts were specifically branded by the City in partnership with local financial institutions. Accountholders would earn the match if they maintained their deposits for at least a year. The opportunity was offered to tax filers at select Volunteer Income Tax Assistance sites, which provide free tax preparation services to low-income households.

The design of the intervention was experimental. It was intended to inform policy development at the federal level by assessing what features could be brought to scale and what features should be modified or eliminated. Accordingly, slight refinements were made each year, mostly to simplify implementation; this included the addition of a $aveNYC Account Asset Specialist to streamline the process to open an account and expanding eligibility from EITC recipients to all filers using the participating VITA sites. In the 2010 season, there was also an increase in the required minimum deposit as well as the deposit amount eligible for a match.

Features of the account and the way in which it was offered were shaped by principles from behavioral economics to maximize participation and savings outcomes. These strategies included the decision to limit the number of choices required of the participants, making account opening easy and deposits automatic to minimize the hassles that could act as barriers to opening an account, segregating the portion of the refund dedicated for saving from the portion returned for transacting and limiting access to the $aveNYC account, and illustrating the amount of the match that would be forfeited if a potential participant opted not to open an account and conveying the match only after the conclusion of the full year term.

Behaviorally Informed Features of $aveNYC

Limiting Choices

- At each VITA site, only one product with fixed features was offered through one financial institution. Prospective participants simply had to opt-in to the program as it was offered and select an amount to deposit.

Minimizing Hassles

- Opening a $aveNYC account took place at the VITA site at the time of tax preparation and a deposit was made directly into the account from the tax return. No additional steps were necessary.
- At the end of the year enrollment term, if not accessed, the account automatically rolls over for an additional year.

Mental Accounting

- Participants may regard money from their tax refund as "irregular" income and be more inclined to save a portion.
- The split refund option facilitated dedicating a portion of a participant's tax refund in a segregated account for savings. The "$aveNYC" brand reinforced this savings function.
- Account access distinguished the function of the account from a transactional account. Teller assistance was required to withdraw funds; no ATM or debit card accompanied the account.

Loss Aversion

- Marketing of the account included an illustration of what a prospective participant would receive with and without the match. Foregoing participation would result in a perceived loss of the match, even though it had not yet been received.
- Participants were required to leave their deposit in the account for the full year term or else forfeit the match and accrued interest.

Significant Findings

Based on data provided by OFE and assessed by the Center for Community Capital at the University of North Carolina at Chapel Hill, the three-year $aveNYC experience has produced a number of significant findings.[22]

$aveNYC Outcomes

- 2,165 accounts opened
- Over 50 percent of participants contributed more than the maximum amount eligible for the match
- $561 average savings (before match)
- Seventy-nine percent of participants saved for the full year term
- Seventy percent of participants continued saving after the required savings period concluded

At the onset of the pilot, program participants were facing a range of financial hardships. One-third reported not being able to pay their rent or mortgage in the previous six months and half could not pay bills or paid them late. Fifty percent had no savings account and 26 percent had no bank account. Their average income was $17,900, just above the official poverty threshold for a parent with two children. Notably, the vast majority of participants were women headed households with children. Since the intervention builds on the value of EITC, which is structured primarily to support families with children, participation in $aveNYC closely mirrored the composition of EITC recipients: seventy-seven percent were women, 78 percent had dependent children, and 89 percent were unmarried.

Despite these imposing challenges, by the conclusion of the third year, 2,200 people had opened an account, and 80 percent maintained their deposit and receive the match at the end of the year term. The average participant saved $561 and over half contributed the maximum amount eligible for the 50 percent match ($500 in 2008 and 2009, $1,000 in 2010). Significantly, 70 percent of participants who received the match continued to save after the official savings period concluded, and almost 30 percent participated in the following year's program.

At the most basic level, the pilot succeeded in encouraging a significant level of savings that likely would not have occurred otherwise. It also has shed light on the set of variables that potentially impact savings outcomes.

Both the direct match incentive and facilitated account opening motivate participation. When surveyed, 67 percent of participants reported that the ease of opening the account influenced the decision to open an account "a lot," ranking just above 64 percent who identified the presence of the match as the reason for opening an account. In a separate survey where ease of opening an account was not among possible options, the direct match was identified as the "most important reason" for opening an account. These institutional supports made saving convenient and valuable for participants with little to no saving experience.

An individual's existing relationship with banking and saving is a predictor of participation and completion. Participation among filers who direct deposited their refund into an account was almost twice the rate among all eligible participants. Participants banked at the start of the program were twice as likely to receive the match, and participants with a regular savings habit were also more likely to persist. $aveNYC helped increase participants' financial capabilities by creating an accessible entry point for new savers and reinforcing the savings behavior of participants already engaged in saving.

A larger refund is a predictor of participation and larger initial deposit. Participants with refunds over $1,500 are nine times more likely to open account, and on

[22] The program data cited in the remainder of the paper has been complied from the following sources produced by OFE and the Center for Community Capital: Center for Community Capital (2010), Mahon (2010), New York City Department of Consumer Affairs, Office of Financial Empowerment (2009), New York City Department of Consumer Affairs, Office of Financial Empowerment (2010), and Ratcliffe, Grinstein-Weiss, Richardson, and Key (2010).

average contribute $258 more into that account, than those with refunds under $500. Since households with low incomes can have significant refunds and may perceive that lump sum, non-wage income as available for saving, coupling this "windfall" of savable resources with a simple, easy-to-open account can translate to successful saving outcomes.

A larger initial deposit "anchors" participants to their account and predicts completion. In the first two years, people most likely to close accounts after the first year were those who had put in the minimum $100 deposit. Thirty-two percent of filers who contributed less than $200 closed their account before receiving the match, compared to only 16 percent of filers who saved more than $200. This finding could suggest that the amount of the initial deposit is a proxy for the level of commitment the participants have to saving or that households that make a low deposit are least able to divert resources from consumption and require the amount that they invested for immediate uses.

The match limit acts as a savings target. In all three years, about half of participants saved up to the match. A doubling of the match limit from $500 in 2008 and 2009 to $1,000 in 2010 resulted in an increase in average savings from $380 to $700, without a decline in participation. It is important to note that at the same time the average refund amount increased from $3,303 to $4,155 as a result of the EITC and Child Tax Credit expansion passed in the Recovery Act, and as previously discussed, the size of the initial deposit is linked to the size of a participant's refund. While the effects of each variable could not be distinguished from each other, the observation that the match limit is treated as a savings target is consistent with other matched savings experiences.[23]

The concept being evaluated by $aveNYC was that short-term, unrestricted use savings can provide a "first step" to saving. Movement from one step to the next was determined by proximity and inertia, and both indicators were successfully demonstrated over the three year pilot.

It was clear that alignment of the product with the savings need provided an accessible entry point for low or new savers. Seventy-three percent said that saving for emergencies or general purposes was their primary objective and the $aveNYC product offered supported saving for those purposes. The account was also offered at a time that coincided with a "windfall" moment where households were most easily able to devote those resources to saving. Second, while half began with no savings account and 63 percent had less than $500 in savings, 80 percent of the participants successfully saved an average of $561 for the full year term and 70 percent of those participants continued saving beyond that point and have accumulated an average of $1,000. The results of the pilot show that a similar policy employing this concept could successfully catalyze the saving and saving behavior necessary for continued financial stability in the near term and economic mobility over the long term.

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Policy Implications: Designing a Savings Incentive at Tax Time

The findings of the $aveNYC experience can inform the process of designing policies to promote a range of savings objectives. Fundamentally, the intervention was effective because it leveraged the infrastructure around the tax filing moment by connecting it to an accessible financial product that was made more attractive by a simple and easily understood incentive. Here are some of the most significant policy implications.

Tax time is the right time. The value of the tax refund and infrastructure of the tax filing process provided the

[23] Sherraden (2010); Sodah and Lister (2006).

platform from which to offer the $aveNYC account. Four out of five participants claimed the EITC, and claimants received a refund that averaged $3,800 more than non-claimants. Both the decision to participate and the amount deposited into the account were linked to the size of the refund individuals received, making the EITC a key component of the success of the intervention.

Access to an account is foundational. The option to open an account during tax filing creates opportunities to save even among those without a preexisting account. Half of $aveNYC participants did not have a savings account prior to participation, so tax filing was the point of access and facilitated the decision to save. Additionally, the ease of account opening at the time of filing reduces the "hassle factor" and was cited as the highest consideration for opening an account among participants.

Match parameters send powerful signals. Larger initial deposits create an anchor that predicts successful completion. This outcome can be encouraged by establishing a minimum deposit or by a match limit. $aveNYC was able to increase its minimum deposit from $100 in 2008 and 2009 to $200 in 2010 without adverse effects on participation. In those same years it increased its match limit from $500 to $1,000 and increased average deposits from $380 to $700.

Savings products should support savings needs. Participants most frequently identified meeting consumption related needs as their goal for saving. A product like a short-term certificate of deposit (12-month CD) offers a vehicle appropriate to that need by offering a term of maturation short enough to make the temporary financial sacrifice for saving achievable, not restricting uses for the savings at the end of the term, and allowing access to the produce before the end of the term if necessary. Savings Bonds would offer similar features. The partnering financial institutions will need consultation when determining the product that will be offered, but certain standards should be established so that the account meets the needs of its owners.

Limited access to the account and match reinforces the savings choice. Limiting access to the account and awarding the match at the end of the one-year term rather than at the time of filing reinforced the "mental accounting" and "loss aversion" that contributed to program participation and completion. Fifty-nine percent reported participating because the funds would be hard to access. However, given that one of the objectives of the account is to equip participants with the resources to deploy in times of unexpected decrease in income or increase in expense, accessing those resources at those times should not be viewed as a failure, and participants should be able to withdraw funds without penalty, aside from the loss of the match.

Additional Learning Opportunities

Continuing to observe participants' savings trajectory initiated by their $aveNYC experience can generate additional insights. Do they have sufficient balances to address emergency situations and provide for their immediate needs? Are there other behavioral changes that coincide with their increase in savings? Is there an increase in other financial and non-financial markers of wellbeing? Do they take subsequent steps toward longer-term investment? Some of these questions will be explored over the next 3 years as $aveNYC is expanded in subsequent sites through the SaveUSA initiative. Tulsa, Newark, and San Antonio are each offering similar programs in 2011 through a federal Social Innovation Fund grant administered by the Corporation for National and Community Service.

$aveNYC is also part of a broader suite of federal efforts to connect low-income households with financial services and build savings. Treasury is launching a pilot this tax season to provide tax refunds loaded onto prepaid debit cards rather than check, and some participants will have an option of depositing part of their refund into a linked savings account. The IRS is offering for the second year the option to purchase a U.S. Savings Bond at the time of tax filing through the "split refund" option. Bank On USA, building on the success of local Bank On demonstrations across the country, is building partnerships with local financial institutions to increase access to safe and affordable financial services for unbanked and under-banked households.[24]

These initiatives should provide a means to broaden the understanding of savings behavior, especially among a targeted lower-income population. Yet it is not too early to confirm the tax time moment as a particularly valuable opportunity to offer an intervention which leverages tax refunds for saving purposes. Taking advantage of this moment can be increased when meaningful incentives are provided and account access is facilitated. These are primary pillars that can support savings even among households with low incomes and resources.

In this spirit, The Saver's Bonus proposal provides a model for a federal policy solution that incorporates these design elements with demonstrated success and applies them to support the multiple savings needs that families encounter. The outcomes of $aveNYC speak both to the need for this type of policy and the potential for its success on a national scale.

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[24] Phillips, Leigh and Anne Stuhldreher (2011).

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