Financial Products Innovation Fund

INNOVATIONS FOR POVERTY ACTION

THIS PROJECT WAS SPONSORED BY

FORDFOUNDATION

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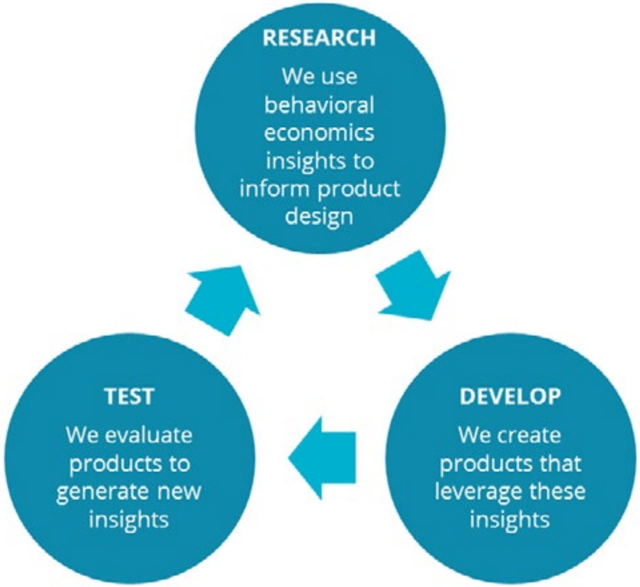
Our Vision

Secure financial lives for all households.

About

Innovations for Poverty Action (IPA) is a non-profit organization dedicated to discovering and promoting effective solutions to global poverty problems. In close partnership with decisionmakers—the policymakers, practitioners, investors, and donors working with the poor around the world—we design and evaluate potential solutions to poverty problems using randomized evaluations, the most rigorous evaluation method available. We also mobilize and support these decisionmakers to use these solutions to build better programs and policies at scale. Since our founding in 2002, the results of our research have improved the lives of over 50 million people around the world.

Established in 2009, the US Household Finance Initiative (USHFI) leads IPA's US research. Directed by researchers Jonathan Zinman (Dartmouth College) and Dean Karlan (Yale University), the initiative uses insights from behavioral economics to develop, rigorously evaluate, and scale cost-effective financial products and product innovations that help low- to moderate-income households lead healthier financial lives.



FINANCIAL PRODUCTS INNOVATION FUND

One of the most important ways in which USHFI achieves its mission is through the development and evaluation of new innovations in financial products.

With the support of the Ford Foundation, the US Household Finance Initiative has institutionalized a pipeline for the development of new innovations in financial products.

Financial Products Innovation Fund I

The Financial Products Innovation Fund (FPIF) is a competitive research fund supported by the Ford Foundation. In the first round of the FPIF (April 2011 - April 2013), the fund awarded seven pilot grants of $15,000 each. IPA received 25 applications from for-profit and nonprofit financial institutions to collaborate with USHFI research network members on the development and market testing of new products and product features. These were then vetted by the US Household Finance Initiative. In addition to seed funding, USHFI provided partners with technical assistance and an independent, non-randomized evaluation of the product pilot test, investigating demand, usage, and scalability.

Financial Products Innovation Fund II

The second phase of FPIF, which started in April 2013, will rigorously evaluate the impacts of two of the most promising innovations from the first Fund, using randomized control trials.

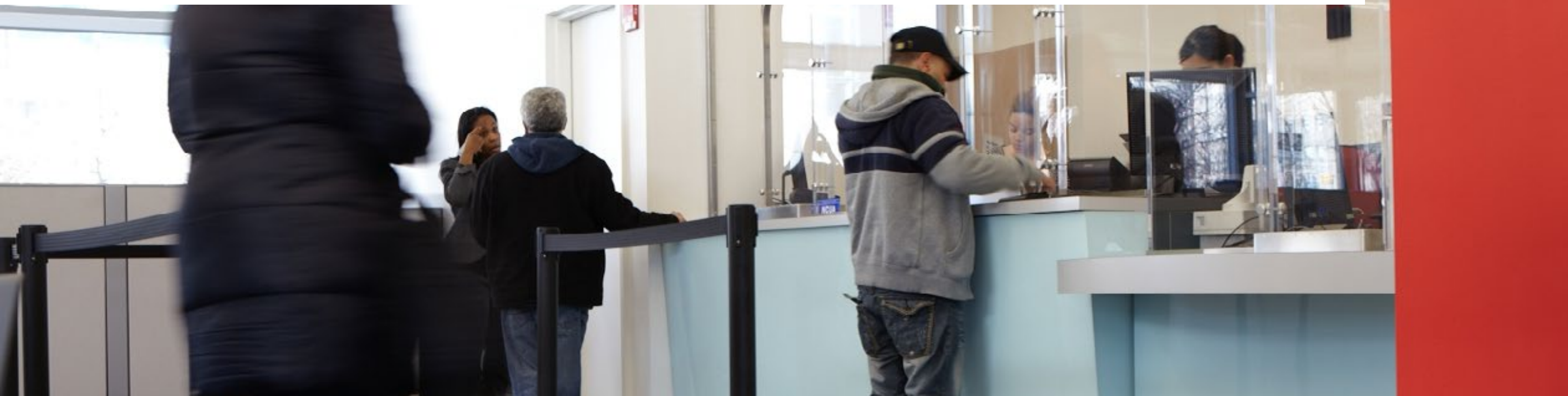
In addition, FPIF II will award four grants of $15,000 in catalyst funding to implementing financial institutions and financial service providers for a second round of innovative product pilots.

For more information about USHFI or our products, please visit: **www.poverty-action.org/ushfi**

PATHWAY TO IMPACT

1. Identify gaps in existing research & market landscape
2. Develop new financial product innovations
3. Market test new financial product innovations
4. Rigorously evaluate products with randomized control trials
5. Disseminate results & promote successful innovations
6. Scale-up successful products
7. Better financial products are available at scale
8. Increased financial security for low- to moderate-income American families

BEHAVIORAL INSIGHTS FOR INNOVATIVE FINANCIAL PRODUCT DESIGN



A large body of evidence suggests that the following behavioral biases cause people to make choices that do not always enhance their welfare:

PRESENT BIAS We have a strong preference for instant gratification, often prioritizing consumption today over saving for the future.

LOSS AVERSION We weigh the cost of potential losses more heavily than the payoff from potential gains, leading us to avoid risking a loss even when the odds may be in our favor.

PLANNING FALLACY We may be overconfident or overly optimistic about the time it takes to complete a task.

LIMITED ATTENTION When making decisions, we may fail to weigh all of our options or consider all of the relevant factors. Because of our limited attention, we may forget to do things that once seemed important.

EXPONENTIAL GROWTH BIAS We underestimate the rate at which interest compounds; savings appear less lucrative and credit with “low monthly interest rates” appears deceptively cheap.

ANCHORING We may place too much emphasis on the first piece of information that is presented to us.

THE TRUST CARD

The 'un-' credit card for people with overwhelming credit card debt

Neighborhood Trust created the Trust Card, a credit card that helps people pay off debt and stay debt free. Borrowers consolidate their debt onto a single card with a fixed monthly payment that does not decline with repayment of outstanding balance. As they pay down debt, only a portion of the repayments are released in the form of new credit, leading to a long-run decline in the borrowers' overall credit limits.

CHALLENGE Standard credit card features such as high credit limits and low monthly payments encourage over-borrowing among consumers.

BEHAVIORAL BIASES Present bias, anchoring, exponential growth bias.

OPPORTUNITY Consumers commit to repay debt and limit their available credit.

TAKE-UP AND USAGE

Between April 2012 and September 2013, 40 cards were opened. More people expressed interest in the card but were ineligible due to various reasons, such as high debt-to-income ratios or unpaid collections.

Individuals that adopted the Trust Card used the product as intended—borrowers closed existing revolving debt accounts and were prohibited from opening other accounts. Thus their credit card balances as a whole declined. The average borrower consolidated $7,134 in debt on the card, and 12 borrowers had paid off their balance entirely at the time of reporting. Clients made average payments of $221 per month.

LESSONS LEARNED AND SCALE-UP

Preliminary evidence suggested that requiring people to cut up their existing cards may have reduced take-up. Future product offers may relax or eliminate this requirement.

Neighborhood Trust is currently partnering with the Filene Research Institute to scale the Trust Card across credit unions nationwide.

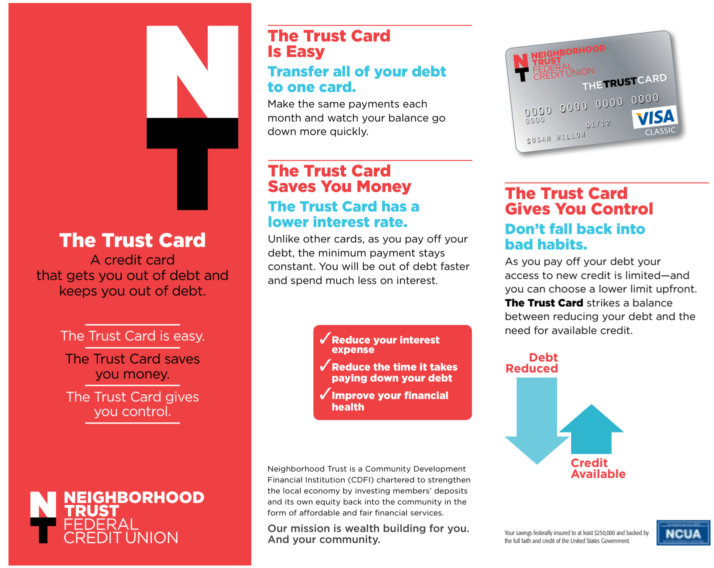
PRODUCT FEATURES

- Consolidation of up to $10,000 in credit card debt
- Only a portion of repayments are released in the form of new credit
- Commitment to closing existing credit cards and not opening new cards
- Fixed monthly payments
- APR of 15% on existing balances, 16.5% on new purchases
- Temporary penalty rate of 18% after two missed payments

NEIGHBORHOOD TRUST FEDERAL CREDIT UNION

PARTNER

Neighborhood Trust Financial Partners (NTFP), a 501c3 nonprofit, and Neighborhood Trust Federal Credit Union (NTFCU) work in tandem to achieve a shared mission of financial inclusion. The credit union serves the predominantly Latino immigrant communities of Upper Manhattan. It also acts as a product innovation lab, testing products for NTFP to deliver at scale via its nationally expanding financial counseling services.



SAMPLE TRUST CARD MARKETING BROCHURE

> *"We had a firm grasp on the concept in broad strokes of what we wanted to do. We really loved the idea of a credit card that was still giving people a piece of plastic, but enabling them to consolidate their debt so they had one credit card structured to encourage principal reduction. Yet, what we learned, and what IPA really helped us with, is that the devil is in the details—that there's so much around how people actually respond to the features of their product."*
>
> – **Justine Zinkin,** *CEO, Neighborhood Trust*

THE GOAL IS FREEDOM (TGIF) LOAN

A loan with an incentivized "cool down" period before funds are made accessible

The Goal is Freedom (TGIF) loan offers borrowers the choice to wait five days before receiving their loan funds in exchange for an interest rate reduction. The ultimate goal is to promote reasoned rather than hasty financial decision-making. The five day cool down feature also doubles as a low-cost screening device that helps lenders identify seemingly marginal applicants who are actually relatively good credit risks. We posit that those who are able to plan further in advance are likely to be better borrowers overall.

CHALLENGE Small dollar loans are expensive and have high default rates.

BEHAVIORAL BIAS Present bias.

OPPORTUNITY To promote responsible borrowing, give borrowers an incentive to wait before receiving loan funds.

TAKE-UP AND USAGE

Our implementing partner, Freedom First Federal Credit Union received 781 small dollar loan requests from August 2012 to March 2013. They estimate that 100 of these applicants were offered the TGIF loan. Of those 100 applicants, 40 customers completed surveys and accepted the TGIF delayed disbursement deal, and 34 applicants were approved for the TGIF loan.

Based on Freedom First's estimate of the number of actual product offers made (100), take-up was 34%. Analysis of administrative and survey data suggests that the interest rate reduction drove this strong customer response.

PRODUCT FEATURES

- In return for a 1.5% reduction in APR, prospective borrowers agree to wait five days before receiving loan funds
- Unsecured loan
- Fixed term (12 to 60 months)
- Loan amount of $250 - $3000
- Fixed monthly payments, with no prepayment penalty
- Eligible for the Loan Emergency Fund add-on

LESSONS LEARNED AND SCALE-UP

Future product development may experiment with different interest rate structures to increase take-up, given that Freedom First already offers a range of discounts. The product could also be marketed by stating the value of waiting in dollar terms rather than in interest rates.

ADD-ON:
THE LOAN EMERGENCY FUND (LEF)

A pre-approved credit line that borrowers cannot activate until they discuss their need for immediate liquidity with a Freedom First loan officer

- Unsecured line of credit
- Open-ended loan term
- Loan amount of $250 - $3,000
- Interest rate of 16%

Given that any loan product can be modified to include the delayed drawdown feature, this product is highly scalable. Moreover, the two features piloted thus far, the cool down period interest rate reduction and Loan Emergency Fund, could easily be adapted to fit operational constraints.

For example, instead of offering an APR reduction as an incentive, the waiting period could be made a pre-condition of loan approval or could be offered in exchange for a longer loan maturity term. IPA believes that initial take-up and usage results from the TGIF loan pilot are promising and warrant continued evaluation.

FreedomFirst
Where people bank for good

PARTNER

Freedom First Federal Credit Union is a full-service community development credit union serving the Roanoke and New River Valleys in Virginia. Founded in 1956, Freedom First is a member-owned financial institution with nine branches, more than 47,000 members, and over $300 million in assets. Freedom First is certified by the US Department of the Treasury as a Community Development Financial Institution (CDFI), and with 61% of members designated as low-income, it is also designated a Low-Income Credit Union by the National Credit Union Administration (NCUA). These designations allow Freedom First to provide a set of affordable, responsible products and services to low-income consumers who are vulnerable to predatory lenders and are typically ignored by banks that see them as unprofitable.

GET SAVING!

Pre-commitment to make regular contributions toward savings after successful DMP completion

IPA developed Pay Yourself Back to leverage the payment habit developed during debt repayment to seamlessly convert borrowers into savers. The concept is simple: borrowers make a commitment to continue to make “payments” after they have finished paying off their loan. Instead of going to a lender, however, these payments go towards the person’s own savings account. The person is thus “paying themselves back.”

Get Saving! is a variation of Pay Yourself Back, which was designed to help consumers meet savings goals by automating savings deposits following the completion of a Debt Management Plan (DMP). Lutheran Social Service of Minnesota (LSSMN) began offering Get Saving! in May of 2012 to customers completing DMPs. (Note: Savings accounts are held at other institutions because LSSMN is not deposit-taking.)

CHALLENGE Many individuals find it difficult to save regularly for the future.

BEHAVIORAL BIASES Present bias, limited attention.

OPPORTUNITY Consumers commit to make regular contributions towards savings after successful DMP completion.

TAKE-UP AND USAGE

LSSMN reached 453 clients completing their DMPs through marketing mailings. Of these clients, LSSMN contacted a subset of 196 through additional outreach phone calls. A total of 51 clients expressed interest in Get Saving!, and 7 clients ultimately set up an account.

Users of the Get Saving! program had ending savings balances of $798 on average, with balances ranging from $0 to $3,801. IPA plan to test Pay Yourself Back at a larger scale so as to understand the true effects of the program.

PRODUCT FEATURES

- Customers commit to continue making payments after the loan term ends
- Contributions to savings equal the total—or a significant portion—of the loan payment amount.
- Reinforcement through messaging—for example, individuals who had paid off a home or auto loan were encouraged to begin saving for maintenance

LESSONS LEARNED AND SCALE-UP

The product should be offered earlier in the loan cycle as many individuals who did not accept the offer noted that they had already planned to allocate the amount that had been devoted to their monthly loan payments to other purposes. Additionally, customers should be reminded of their commitment at regular junctures, perhaps via text message reminders, as they pay off their loan.

IPA is currently partnering with the Filene Research Institute to scale Pay Yourself Back across credit unions nationwide. In addition, we are testing different features of the product, including varying the length and amount of the savings commitment.

GET SAVING! MAILING INSERT

Lutheran Social Service of Minnesota
for changing lives

PARTNER

Lutheran Social Service of Minnesota has a staff of 2,300 serving 100,000 people across Minnesota's 87 counties. It is the state's largest nonprofit social service organization. The LSS Financial Counseling program began in 1987, with the goal of helping people gain control of their finances and achieve financial wellness. LSS Financial Counseling provides budget and debt counseling, debt management plans foreclosure prevention counseling, reverse mortgage counseling, bankruptcy counseling and education, credit report review, and financial education services.

> *Get Saving! was a great experience to be able to connect with our clients who enrolled in our Debt Management Plan and provide them with an option coming out of their DMP that would be a healthy way for them to continue to stay financially responsible."*
>
> **– Amy Lee,** *LSS Financial Counseling, AmeriCorps Financial Follow Up Specialist*

SEAMLESS BORROWING TO SAVING

Pre-commitment to make regular contributions toward savings after successfully repaying a loan

Seamless Borrowing to Saving (a modification of Pay Yourself Back—see Get Saving! for more information on this product) helps develop savings habits by harnessing the regular payment habit people develop through loan repayment. The program consists of an up-front commitment on the part of customers to continue making payments after their loan term ends—but rather than paying the credit union, they "pay" themselves in the form of savings.

Participating credit unions from Montana Credit Unions for Community Development (MCUCD) began offering Seamless Borrowing to Saving in May of 2012 to customers completing loan terms.

CHALLENGE Many individuals find it difficult to save regularly for the future.

BEHAVIORAL BIASES Present bias, limited attention.

OPPORTUNITY Consumers commit to make regular contributions towards savings after successful loan repayment.

TAKE-UP AND USAGE

The three participating credit unions together made 187 phone offers of Seamless Borrowing to Saving. A total of 16 individuals took up the offer. Take-up rates differed across the credit unions, ranging from 5.1% to 14.7% where the product was marketed most effectively.

Seamless Borrowing to Saving was primarily applied to personal and unsecured loans. On average, users pledged to deposit $136 into their accounts and made monthly savings commitments equal to 66% of their monthly loan payments. IPA plan to test Pay Yourself Back at a larger scale so as to understand the true effects of the program.

PRODUCT FEATURES

- Customers commit to continue making payments into savings after the loan term ends
- Contributions to savings equal the total—or a significant portion of—the loan payment amount.
- Back-end automation and ACH payments enable a seamless transition from loan payments to savings

LESSONS LEARNED AND SCALE-UP

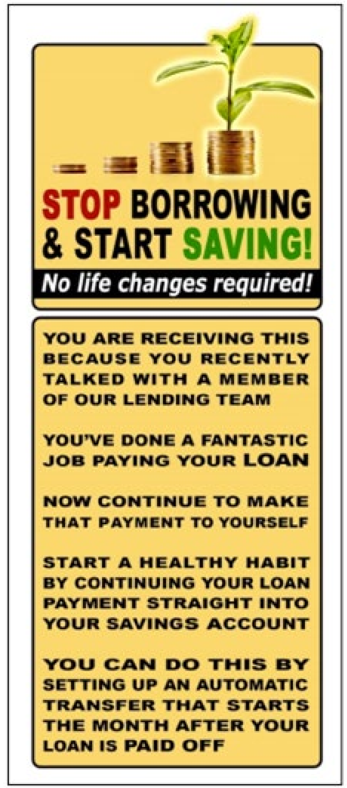
The product should be offered earlier in the loan cycle, as many clients noted they had already allocated the amount devoted to their monthly loan payments to other purposes. Furthermore, customers should be reminded of their commitment at regular junctures as they pay off their loan.

Staff buy-in is critical to ensuring that customers are exposed to the program. IPA is interested in testing different product features in future offerings of Pay Yourself Back. IPA is currently partnering with the Filene Research Institute to scale Pay Yourself Back across credit unions nationwide. In addition, we are testing different features of the product. Encouraging clients to set specific savings goals at the time they pre-commit to using Pay Yourself Back or experimenting with the timing of the Pay Yourself Back offer are two examples of product variations.

PARTNER

Montana Credit Unions for Community Development is a non-profit that seeks to improve the social and economic well-being of families living in the state of Montana through partnerships with credit unions to provide services such as free tax preparation, Individual Development Accounts (IDAs), Matched Education Savings Accounts (MESAs), and financial and consumer education.

For the Seamless Borrowing to Saving project, MCUCD collaborated with three credit unions: Park Side Federal Credit Union, Altana Federal Credit Union, and Billings Federal Credit Union.



SEAMLESS BORROWING TO SAVING MAILING INSERT

“*I think that in a lot of ways it's kind of a no-brainer concept. Absolutely you've already got this money going someplace each month, what an easy transition... [but] most people take out a loan 3-5 years in length, and so [we learned that] those conversations have to start right away when you're taking out that loan and not a couple of months before you're paying off.*”

– Karen Smith, *Executive Director, Montana Credit Unions for Community Development*

CASH & STASH

A savings account that offers the option to set aside money every time a check is cashed

RiteCheck partnered with Bethex Federal Credit Union to offer Cash & Stash savings accounts to check cashing clients. Each time a client cashes a check at a RiteCheck branch, they can "impulsively" save a portion of their cash in these accounts (accessible at both RiteCheck and Bethex Federal Credit Union). The product offers populations reliant on alternative financial institutions a formal financial product that meets their needs. Cash & Stash is a variation of Frictionless Savings—a product designed to help consumers save more by simplifying the process of setting money aside.

PRODUCT FEATURES

» Client is prompted to save each time they cash a check

» Interest bearing (0.5%)

» No withdrawal fees, no monthly service fees

» No restrictions

» No minimum balance

» $5 deposit to open account

CHALLENGE It is easy to spend on impulse but it is harder to save on impulse.

BEHAVIORAL BIAS Limited attention.

OPPORTUNITY Redirect impulsivity towards savings at the moment when consumers are most liquid.

TAKE-UP AND USAGE

Cash & Stash was first offered in March 2013. By the end of June 2013, RiteCheck had opened 93 Cash & Stash accounts. Offers were not tracked, so it is difficult to estimate take-up precisely. Between March and June 2013, average deposits were $53 and average withdrawals were $79.

LESSONS LEARNED AND SCALE-UP

Difficulties integrating the software systems between RiteCheck and Bethex has constrained the number of Cash & Stash accounts RiteCheck has been able to manage. These operational constraints should be addressed in the early stages of product development. Additionally, some focus group participants expressed an interest in developing a rewards system for those who maintain significant savings balances over time. RiteCheck aims to roll out Cash & Stash in each of its 12 branches. IPA and RiteCheck are currently in discussions to combine this expansion with a randomized evaluation of frictionless savings.

RiteCheck

PARTNER

RiteCheck Cashing, Inc. is a leading nonbank financial service provider that offers check cashing, bill payment services, money orders, remittance transfers, prepaid products, direct deposit, and business services through twelve branches in Harlem and the Bronx in New York City. RiteCheck has partnered with Bethex Federal Credit Union to offer free and reduced-fee transactions to Bethex clients using RiteCheck's extensive branch network to cash checks, make deposits, and access other services. In exchange, Bethex is able to market its products and services to RiteCheck's unbanked and under-banked clients. Bethex is a Community Development Financial Institution located in the Bronx, with 5,000 members and $28 million in assets.

CASH & STASH FLYER

"I thought I knew everything about what my customers wanted...if our customers needed their money they needed it, so they wanted to feel they had the freedom to save it as long as they knew if they needed it they could get it back. So I knew that was a critical component, and I knew it had to be liquid... But now that I'm actually doing it, the customers are surprising in the different ways they're using the product."

– Joseph Coleman, *President, RiteCheck*

5 FOR ME

A pre-commitment to deposit $5 into savings every time a check is cashed

With 5 for Me (a variation of Frictionless Savings), check cashing clients at Self-Help's Community Trust Prospera (formerly Micro Branch) branches in San Jose can pre-commit to making a minimum $5 deposit into their savings account each time they cash a check. The product creates a clear path to saving at times when consumers are most liquid.

CHALLENGE It is easy to spend on impulse but it is harder to save on impulse.

BEHAVIORAL BIAS Limited attention.

OPPORTUNITY Redirect impulsivity towards savings at the moment when consumers are most liquid.

TAKE-UP AND USAGE

Between April 2012 and July 2013, 79 individuals opened accounts. Clients also used the product as intended—on average, clients made 1.17 deposits per month into their 5 for Me accounts and the average account balance was $57. Some clients did draw down their savings.

PRODUCT FEATURES

- Client saves a minimum of $5 each time a check is cashed
- Dividends paid on balances of $100 or more
- Unlimited deposits
- Up to six monthly withdrawals without fees
- No monthly service fee
- $10 required to open the account
- $25 fee for closure of the account within 6 months

5 FOR ME POSTER

LESSONS LEARNED AND SCALE-UP

Some key lessons learned were about the marketing and design of frictionless savings, such as the relative importance of tellers educating and enrolling clients (versus in-branch print materials), the need to hold regular training sessions so that staff keep the product front of mind, and the value of streamlining the account set-up process. In order to increase savings levels, it may also be important to experiment with the default savings amount and other nudges to saving. Because of the initial success of the product, Self-Help aims to secure greater participation among its San Jose clients while expanding the product offering to its new branches in Los Angeles.

Self-Help FEDERAL CREDIT UNION

Community Trust • Second Federal • CT Prospera

PARTNER

Self-Help is a community development lender, credit union, and real estate developer that works with individuals, organizations, and communities traditionally underserved by conventional markets. Since 1980, Self-Help has provided more than $6.38 billion of financing to over 81,000 families of modest means, small businesses, and nonprofit organizations across the country. In 2010, Self-Help launched a new model designed to attract unbanked families into the financial mainstream. A hybrid of check casher and a credit union branch, Community Trust Prospera "meets unbanked customers where they are" by providing check cashing, remittance, and other services in addition to credit union products in a convenient and comfortable environment.

"*The opportunity to work with specialists in behavioral economics at IPA provided incentive for us to move forward with our idea, and launch it with their support.*"

\- **Jeannine Esposito,** *Communications & Development Associate, Self-Help*

THE NOW & LATER ACCOUNT

A planned withdrawal income-smoothing account

Many families under the federal poverty line in New York City earn their income in lump sums, creating a "feast or famine" cycle. For example, a household can receive as much as 40% of its income at tax time, or a student may get half of her student aid at the beginning of each semester. Stretching these lump sums to pay for future fixed expenses can create budgeting challenges and promote reliance on credit.

Through the Now & Later Account, The Financial Clinic clients deposit a lump sum into a planned withdrawal account (held at Spring Bank). The account restricts the client's access to their funds, except for monthly "payments" transferred to the client's checking account, in an amount pre-determined by the client. This aids in stretching out these lump-sum payments. These accounts may support mental accounting and budgeting skills that will enable clients to increase their savings and financial security over time.

CHALLENGE It is difficult to stretch lump sum payments in order to pay for future expenses.

BEHAVIORAL BIASES Present bias, planning fallacy, limited attention.

OPPORTUNITY Match the release of lump sum payments to year-round expenses.

TAKE-UP AND USAGE

There is still much to learn about take-up and usage of The Now & Later account because the product has not been widely offered. As of August 2013, just one account had been opened.

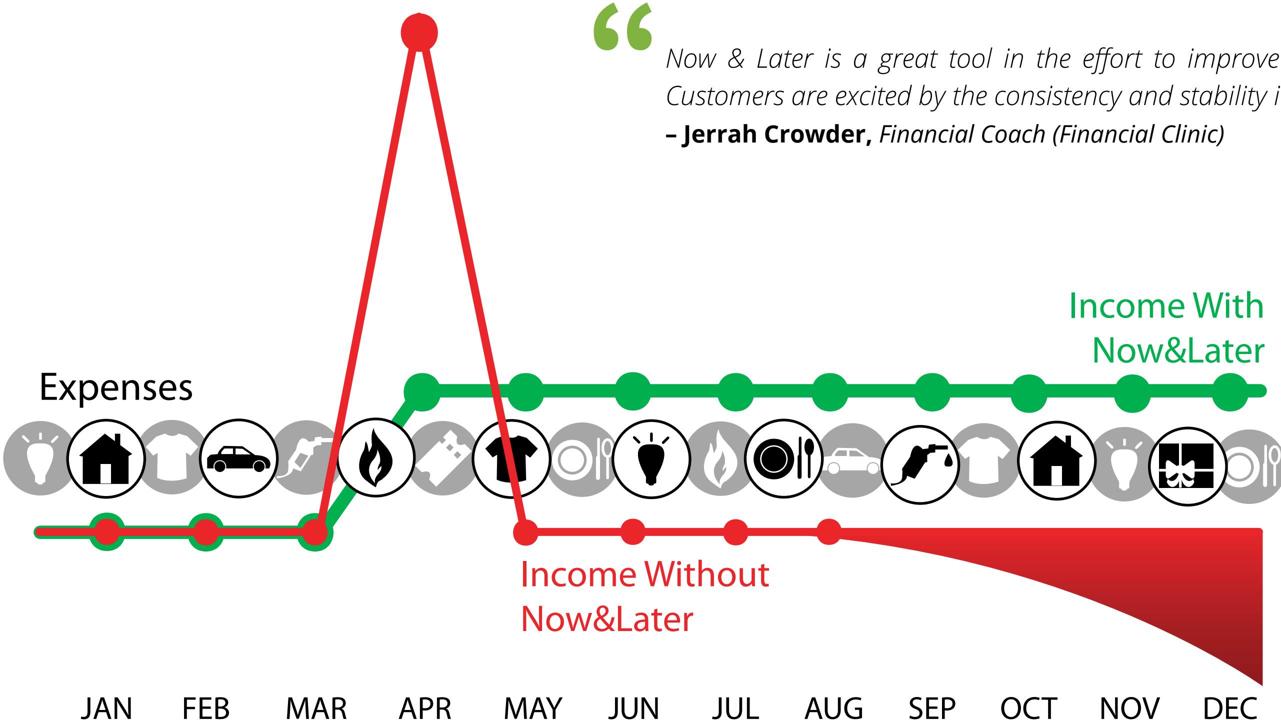
PRODUCT FEATURES

- Account holders agree to a self-determined, budgeted withdrawal schedule and can only access their monthly amounts.
- Interest-bearing savings and checking account offered by Spring Bank
- No monetary penalties
- Monthly maintenance fee of $1
- Free monthly withdrawals
- Unused balances roll over to next month
- "Hardship withdrawal request form" required to withdraw full balance

LESSONS LEARNED AND SCALE-UP

In order for such a product to be successful, the process must be streamlined for customers. For example, by minimizing paperwork and required documentation. IPA intends to continue seeking new avenues to refine and pilot the product and The Financial Clinic is working within its community college partners to explore the possibility of reaching students through financial aid offices.

"Now & Later is a great tool in the effort to improve financial habits. Customers are excited by the consistency and stability it provides."
– Jerrah Crowder, *Financial Coach (Financial Clinic)*



SAMPLE NOW AND LATER ACCOUNT MARKETING MATERIAL

THE FINANCIAL CLINIC

PARTNER

The Financial Clinic provides a variety of services aimed at building financial security for working poor families in New York City and Newark by addressing immediate financial challenges and helping set long-term goals to achieve financial mobility. These services include one-on-one financial counseling, tax preparation, financial education workshops, and legal assistance with bankruptcy, tax, and consumer law. The Financial Clinic started providing services in 2005 and now reaches over 4,500 families a year.

ROUND II

Stay tuned for the second round of the Financial Products Innovation Fund:

2 RANDOMIZED CONTROLLED TRIALS

From 2013 to 2015, IPA and partners will rigorously evaluate two of the most promising innovations from the FPIF I via RCT.

4 CATALYST GRANTS

FPIF II will award four grants of $15,000 in catalyst funding to implementing financial institutions and financial service providers for another round of innovative product pilots.

"

FPIF got us out of our comfort zone, got us to try something new. We're really happy with what we've created and are looking forward to it actually, really going live...And we knew there were timelines and deliverables so it forced us to be a little more structured in our approach to the development of a product."

– Joseph Coleman, *President, RiteCheck*

OPERATIONAL LESSONS FROM FPIF I

STREAMLINE	*Minimize institutional moving parts and simplify the consumer experience*
MARKETING	*Encourage early planning of marketing efforts*
STAFF BUY-IN	*Ensure staff buy-in from the start of product development*
TIMING	*Reach consumers earlier in the decision-making process*
PRIORITIZE DATA	*Increase investments in data collection*
REFINE	*Iterate on product design lessons after initial rollout*


NEIGHBORHOOD TRUST
FEDERAL CREDIT UNION

INNOVATIONS FOR POVERTY ACTION

US HOUSEHOLD FINANCE INITIATIVE

101 Whitney Ave
New Haven, CT 06510
USA

Phone: +1 203.772.2216
Fax: +1 203.772.2428
www.poverty–action.org/ushfi