THE SAVING GATEWAY

FROM PRINCIPLES TO PRACTICE

SONIA SODHA AND RUTH LISTER

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Executive summary

These are exciting times for the asset-building agenda in the UK. In recent years, conceptions of the welfare state have undergone significant change. No longer is the welfare state simply about income assistance and public service delivery, but it is seen as an empowering force, enabling people to bring about change in their own lives and opening up opportunities. Asset-based welfare has an important role to play in realising this vision.

Asset-based welfare has represented a new policymaking frontier since 1997. It was back in 2000 that an ippr paper first recommended an asset-based approach for the UK. Since then, the Labour government has introduced a number of reforms designed to enable increasing numbers of people to benefit from asset ownership. It has established the Child Trust Fund, which gives all children born since 2002 the right to a modest asset at the age of 18, and piloted the Saving Gateway, a matched-saving scheme targeted at those on low incomes.

In these two policies, the foundations have been laid for a welfare state that recognises the contribution that assets make to wellbeing. But the biggest remaining policy challenge lies in developing the Saving Gateway from its pilot status to a sustainable, affordable national scheme. For too long, medium-term saving incentives have been regressive, using tax relief to reward higher income savers, who least need incentives to save. The Saving Gateway represents the opportunity to rebalance the short- to medium-term saving framework, offering progressive saving incentives to those for whom assets can have the greatest impact on financial security and opportunities.

This report revisits the case for progressive saving incentives, and considers how a national Saving Gateway scheme could deliver them.

In Chapter One, **Ruth Lister** considers the role of savings as a coping strategy in the 'vulnerability' context of poverty. She analyses the experience of poverty, using the 'livelihoods framework' first developed in the international development context. Those living in poverty tend to deploy sophisticated budgeting strategies in order to 'get by' in poverty. However, even with these strategies it is difficult to mitigate the negative impact of fluctuations in income and expenditure needs. Getting by carries significant costs: two-fifths of families in the lowest quintile of the income distribution report running out of money by the end of the month, and significant numbers report that they worry about money 'almost all the time'. Moreover, the very strain of getting by can reduce the ability to think or act strategically.

Lister outlines the vulnerability context of poverty. Those living on low incomes are more likely to face income dips or unexpected expenditure needs than the rest of the population. Unsurprisingly, those on low incomes find it hardest to cope with income drops. Debt is a common 'solution' to dealing with income shocks in the absence of savings to fall back on.

Lister goes on to consider the role of savings as a way of coping with poverty. She argues that evidence from the first Saving Gateway pilot gives some support to the hypothesis that the existence of savings creates a greater sense of material security among people on low incomes and, to a lesser extent, enhances their feeling of being in control over their lives, thereby strengthening their resilience and ability to cope in a difficult vulnerability context. Yet those living on low incomes and in poverty are least likely to have access to financial assets.

She concludes that savings can be an effective way of coping with the vulnerability context of poverty, and that government should therefore build upon the Saving Gateway pilots with policies to encourage those on lower incomes to save. However, she also cautions against expecting that people who struggle to get by day by day could or should sacrifice their immediate living standards in order to save. What is needed, therefore, is a strategy that combines policies to encourage and support savings among those living in poverty with other policies to combat the financial insecurity associated with poverty, including improving benefit levels, reform of the Social Fund and improved access to affordable credit and insurance

In Chapter Two, **Sonia Sodha** examines the current structure of short- and medium-term saving incentives, and concludes that it fails those who most need the incentives. She argues that a fair savings policy: should not penalise individuals for saving, should incentivise saving for those least likely to save but who stand to gain the most from it, and should be simple and transparent. The current savings framework fails on these last two criteria: it is regressive and complex.

Rolling out the Saving Gateway pilots on a national basis would go a long way to address this problem. Sodha sets out four priorities for a national scheme, building on lessons from the pilots and previous research on delivering financial products to those who are financially excluded:

- *Targeting*. In order to be as efficient and as affordable as possible, the Saving Gateway needs to remain closely targeted on the low-income groups who need it the most.
- *Local partnership delivery*. To maximise the reach of the scheme, accounts need to be delivered by trusted local intermediaries in the community, such as housing associations, citizens advice bureaux and credit unions. These should play a role in recruitment, assistance with account opening, and delivery of financial capability.

- *Working with the grain of how people think*. The scheme needs to make use of recent insights from behavioural economics on framing effects (the effect of framing options differently) and mental accounting (allowing consumers to attach labels to encourage saving towards set ends) in order to maximise its saving-boosting potential.
- *Financial capability*. The Saving Gateway offers a real opportunity to integrate financial capability education with an interactive, personalised element based around saving into the Saving Gateway account. Evidence on financial education suggests that this is the kind of approach that works.

These four priorities lead her to make the following recommendations for a national Saving Gateway scheme:

Eligibility

- Eligibility should be targeted on low-income households, who are least likely already to have savings, and who do not benefit from current tax-based incentives to save. A simple eligibility test would be for those who are of working age and either on benefits or eligible for Working Tax Credit. Under this definition around 5.52 million people would meet the eligibility criteria in any one year. A preferable (but more complex) eligibility test would extend to all adult members of households eligible for Working Tax Credit, or in which one adult is entitled to benefits, and to low-income working households in which the main earner is under 25 or works part time.

Match rate

- The match rate (the amount government contributes at the end of the account's term) should be as low as is consistent with kickstarting a saving habit, in order to minimise deadweight costs (the amount spent on the scheme that does not increase saving rates) and reduce the profitability of borrowing to save. No decision on match rate should be taken until we have evidence from the completed evaluation of the second pilots, but it could be in the region of 50p for every pound saved.
- The match rate should be doubled for the first two months of the account, in order to provide further encouragement to take part.

Saving into the account

- Saving Gateway accounts should allow savers to designate different proportions of their savings under different headings, for example a holiday, a Child Trust Fund and a pension, in order to take advantage of people's natural propensity for mental accounting.
- Savers should be able to access their account balances. The Government

should match the maximum account balance achieved during the account's term.
- The account should roll over into a savings account on maturity, with an easy option to transfer funds into a Child Trust Fund or pension.

Account length

- The account length should be two years. This is long enough to accommodate some of those who want to save for longer than the 18 months of the pilots. However, it should be made clear to those who want to save for shorter periods that they can withdraw their full account balance at any time as it is, their maximum, not end, balance that is matched at the end of the account.

Providers

- To maximise accessibility and consumer choice, the account should take the form of a product wrapper: in other words, legislation should set out generic terms and conditions for Saving Gateway accounts, within which credit unions, building societies and banks can offer accounts. National Savings and Investments should also supply accounts through the Post Office to ensure national coverage by a trusted provider.

Delivery model

- The account should be available to all who fulfil the national eligibility criteria. Government should contact everyone who is eligible, to eliminate the need for an income test.
- In each local authority area, local organisations such as housing associations, citizens advice bureaux and credit unions should be contracted to deliver a set number of accounts. They would be responsible for recruitment, assistance with account opening and, possibly, delivery of integrated financial advice.
- The accounts should be publicised in the workplace in partnership with employers.
- Information about the accounts should also be available through other networks such as Jobcentre Plus, Sure Start centres, doctors' surgeries and schools, and should be given to Social Fund borrowers when they have paid off their loans.
- Marketing of the account should be focused on areas with low levels of third sector activity.

Financial capability

- Saving Gateway accounts should be linked to tailored, interactive financial education based around the account, provided by local intermediaries involved in delivering the accounts. Savers should be involved in

setting individually-tailored saving targets at account opening.

Assuming a total takeup rate of 30 per cent in the first year, with a third of these accounts delivered by local organisations, and a 50p match rate, costs in the first year would be in the region of £180 million, including the cost of delivery. This is just over 10 per cent of the £1.75 billion the Government currently spends each year on Individual Savings Account (ISA) and Personal Equity Plan (PEP) tax relief. One possible source of funding would be to abolish equity ISAs, on which the Government spent approximately £350 million in 2005/06. Such a change would affect only the wealthiest investors.

So a national Saving Gateway is affordable, and could be very effective in helping people to build up a financial buffer as part of a wider strategy to reduce the financial insecurities of poverty. Rebalancing saving incentives by rolling out the scheme on a national basis should therefore be a priority for the Government.