

Early Concept Document

Please contact
innovation@filene.org
for updated information.



Prize-based Savings Business Plan

**A New Savings
Opportunity for Credit Unions**

Executive Summary

When did we start paying consumers interest on deposit accounts or dividends on share accounts? The most common answer—I can't remember when, but it's been a long time ago. In contrast, ask yourself when did we change the way we listen to music, or watch TV, or prepare our dinner? While the answers to these questions vary, few say a long time ago. Bingo.

It's time to reinvent the way we save. Why? In 2005, the U.S. household savings rate was 0% and nearly 25% of U.S. households had no savings at all. Clearly, the U.S. lags behind in our savings habits compared to other parts of the world.

Our solution—Prize-based Savings. Participation is simple. Money is easily deposited in the designated account. Then, for each dollar or incremental dollar amount the member deposits, they earn an additional entry into the sweepstakes prize drawing. Indeed, the more the member deposits the greater their chances to win a prize. It's also important to note this prize is in *addition to* the deposits they have successfully saved along with the rate of interest paid on the account.

Gambling? No. We're talking about a sweepstakes drawing. Remember, when a member gambles, they have the risk of losing their investment. At no time—unless the account grows beyond federal or state deposit insurance coverage—is the investment at risk.

Implementation risk is also low. Credit unions can choose to pilot the account for a limited time. In addition, consumers find the concept easy to understand as other products and industries, like Visa, have familiarized them with sweepstakes drawings. And finally, this idea can be implemented in a relatively short period of time in any credit union regardless of their asset size.

What is the size of the market potential? While we believe all U.S. households will benefit from the prize-based savings product, there is a greater potential in the lower income households with annual income less than \$30,000 per year. As a matter of fact, the Brookings Institute estimates that over \$8.4 million families earning under \$25,000 per year do not have a checking or savings account. This represents a sizeable opportunity for credit unions.

In summary, the prize-based savings account offers a unique and innovative way to encourage consumers to save. Low and moderate-income families can begin to build stronger, long-term savings habits. In addition, the credit union has the opportunity to attract deposits at a relatively low cost of funds. It is time to reinvent the way we save!

Prize-based savings accounts—more interesting than interest.

Business Description

Many low and moderate-income individuals in the U.S. lack significant savings, and find it increasingly difficult to set aside money. In 2005, the U.S. household saving rate was 0% and nearly 25% of U.S. households had no savings at all. At the same time, Americans spent nearly \$80 billion on legalized gambling, and evidence suggests low-income earners spend a larger percentage of their income in this way.

Survey data collected by the Consumer Federation of America indicates nearly half of low-income earners think they are more likely to accumulate significant savings if they win, than if they actually save.

Financial planners, policymakers, and economists agree families must have savings to survive financial emergencies, plan for the future, and retire comfortably. This background presents an opportunity for credit union innovation.

Prized-based savings products offer a unique way for consumers to save with the added bonus of an opportunity to win cash or prizes.

Product Design

Accessibility and simplicity are key drivers for the target segment. Based on this fact, the product design should be similar to standard credit union share accounts. To participate, a member simply deposits money into the specific prize-based share account.

For each dollar or incremental dollar amount the member deposits, they earn an additional entry into the sweepstakes prize drawing. The member can deposit or withdrawal from the account as needed. There is no penalty for withdrawal. However, the more the member saves, the greater their chances to win.

The design of the product can be flexible to meet the needs of the sponsoring institution. In managing the specific features, each institution can choose to customize their Prize-based Savings product in a variety of ways, including:

- a) Amount required to participate
- b) The interest rate of the product
- c) The frequency of the prize drawings
- d) The value of the prize (cash award, or physical prize)
- e) The rules that govern the number of entries permitted for participants.

Prize Structure

The type of prize offered needs to be alluring to generate interest on the part of the member. From the credit union's perspective, the value of the prize should be affordable. Periodic monthly or weekly prizes keep the members' interest. In addition, the possibility of a large prize keeps the member interested over time and encourages them to save.

As to the type of prize, programs in the United Kingdom offer a cash reward as well as earning a fixed rate of interest. This program is well received in its market. Programs in Latin America offer household appliances as the grand prize to capture the attention of their consumers. The type of prize offered is at the discretion of the credit union.

As an option, the credit union may elect to off-set the cost of the prize by foregoing interest on this account. The interest that would have been paid on the account can serve as a source to fund the prizes. Although there may not be sufficient funds to off-set the first round of prize drawings, the credit union should view this as a marketing expenditure.

Consumer Benefits

Prize linked savings products have been widely successful in the United Kingdom and in South America for decades and could encourage real savings for credit union members in the United States. Indeed, the introduction of a prize-based savings product has important implications for credit unions and their members.

- ◆ The product could encourage savings at a time when new deposits are scarce.
- ◆ There is a positive financial return to the member in addition to the opportunity to win a prize.
- ◆ The features of the account make the product very easy to use for non-savers, as there are no adverse entry requirements, no penalties for early withdrawal, and no hidden fees or other adverse actions as the result of member behavior.

Business Partner Benefits

A prize-based product has the potential to encourage savings for people of modest means, and the attraction of potential new members is particularly appealing. Thus the Prize-based Savings will also:

- ◆ Appeal to the underserved population
- ◆ Create goodwill towards the credit union movement
- ◆ Increase product usage

Marketing

Marketing is key to the success of this product. Because the product is new to the United States market place, efforts to build product awareness are paramount. Much like other new product launches, the marketing expense should be considered an investment in the early stages and should be measured accordingly.

Credit unions may also consider shifting interest expense to marketing expense when establishing the product pricing.

Branding

We've created a unique logo that displays being a "winner." The logo and colors should be consistently used in all printed material to reinforce the brand. Use of this logo is encouraged. However, each credit union should make the branding decision that is right for them.

Training

Buy-in and support from Management is the first step to any successful marketing program. We recommend a training program that includes the entire staff.

It may be best to create an event that employees can actively participate in to feel the excitement around the product. Perhaps a mock account with random account balances equating to raffles tickets would facilitate this process. Low level prizes such as gift certificates and perhaps a grand prize of an iPod could be used.

Importantly, the product should be designed with simple, easy to understand features. The training objective is to generate awareness and enthusiasm for the product. In other words, operational complexity should be very low with this product when compared to a product like an IRA. Again, the product is simple for the consumer *and* the employee to understand and embrace.

Media

Naturally the identified target market drives the promotional strategy. We recommend a mix of print, radio, point of sale, and direct mail. Sample printed materials have been included for you to review. Importantly, we feel this idea has the potential to create an "idea virus" where consumers will be talking about this product and their savings success!

Market Size

To determine potential market for all credit unions, the following three tables indicate penetration of households in the U.S. as tabulated in the 2004 Survey of Consumer Finance which is a triennial survey of the balance sheet, pension, income, and other demographic characteristics of U.S. families published by the Federal Reserve Board.

Credit Union Membership in U.S. Households

Of the 112 million households in the United States, it is estimated that 35% have credit union memberships, with 17% indicating the relationship as primary. Un-banked households represent 8.6% of the total. 35% of households have incomes of less than \$30,000.

Total Households (million)	112.1
<hr/>	
Credit Union Membership	
Any Credit Union Membership?	34.75%
Credit Union Primary/Secondary Financial Institution?	27.12%
Credit Union Primary Financial Institution?	16.67%
Un-banked	8.65%
Savings	
Less than \$500 in Financial Assets	16.22%
Less than \$100 in Financial Assets	10.08%
Household is Asset Poor	42.33%
Income	
Less than \$30,000 in household income	35.44%
<hr/>	

Asset Structure for U.S. Households

This chart details the asset structure for all households in the U.S. It is interesting to note that regardless of the relationship a household has with its credit union, a significant portion earn less than \$30,000 and may be described as asset poor.

Credit Union Membership

Any Credit Union Membership?	34.75%
Credit Union Primary/Secondary Financial Institution?	27.12%
Credit Union Primary Financial Institution?	16.67%

112.1 million x.....	34.75%	27.12%	16.67%
	Any CU Membership	CU Secondary/Primary	CU Primary
Less than \$500 in Financial Assets	8.41%	9.80%	12.49%
Less than \$100 in Financial Assets	4.11%	4.78%	6.30%
Household is Asset Poor	33.19%	35.46%	39.81%
Less than \$30,000 in household income	22.26%	25.05%	28.17%
(Among those with less than \$30,000 in household income)		(35.44%*112.1 million)	
	CU At all	CU Secondary/Primary	CU Primary
Less than \$500 in Financial Assets	23.68%	25.50%	30.56%
Less than \$100 in Financial Assets	12.49%	13.09%	16.02%
Household is Asset Poor	55.90%	58.02%	63.34%

Unbanked Consumer Households

This details the asset structure of the 8.65% of households that are identified as unbanked (approximately 9.7 million households). This obviously represents an opportunity for credit unions to reach underserved or low-income households.

112.1 million x..	8.65%
	Un-banked
Less than \$500 in Financial Assets	75.69%
Less than \$100 in Financial Assets	72.38%
Household is Asset Poor	85.85%
Less than \$30,000 in household income	79.45%
(Among those with less than \$30,000 in household income)	(35.44%*112.1 million)
	Un-banked
Less than \$500 in Financial Assets	81.77%
Less than \$100 in Financial Assets	78.09%
Household is Asset Poor	87.84%

Barriers to Entry

Content

There is little academic or business experience within the United States to determine the potential viability of the product. However, this is partially offset by an extensive historical and contemporary experience in other countries.

Community

It is believed a prize-based savings product will resonate most strongly with families of modest means. Credit Unions with relatively affluent members may find members do not demonstrate interest in the product.

Business Risk

Financial

The introduction of prize-based savings products if widely accepted could change internal or competitor pricing policies in as yet unforeseen ways. This may not necessarily be beneficial to credit union interests. Economies of scale for large institutional players will likely create the possibility of significant prize awards that could greatly exceed credit union capabilities if prize based products become widely accepted in the US.

Reputation Risk

As a new offering, there is some reputation risk that should be considered. The idea of offering an incentive of cash or prizes to encourage consumers to save at first glance may seem gimmicky. Using a feature that encourages a consumer to save in gradual increasing amounts to qualify for more opportunities to win a prize may be perceived as promoting gambling at a basic level.

A secondary concern may occur when the prize is awarded. The winner will be liable for all applicable taxes as defined by federal and state regulations. In the event the prize winner is unable to satisfy these obligations, the reputation of the credit union may be tarnished.

These risks can be mitigated with a well-defined program which clearly outlines the guidelines and rules governing the program. Credit union personnel can meet with individual prize winners and strongly recommend they consult a tax professional to fully understand the laws and regulations governing winnings. Lastly, the implication may be lessened if the consumer is in a lesser tax bracket.

It is our opinion that all of these risks can be overcome.

Legislative and Legal Landscape

Legal jurisdictions within the United States have different laws governing the distribution of prizes, and how this activity relates to financial institutions. If the rules of the prize-based savings product are organized as a sweepstakes (similar to promotions regularly run by major credit card companies in credit unions), legal and regulatory issues are generally more manageable. Each interested credit union will need to discuss this issue with general council to meet regulatory requirements.

Operational Considerations

Once again, simplicity is a key element of the prize-based savings account. Thus, the only true “operational” piece would be in establishing a new share/savings account which accepts both member deposits and withdrawals.

Technology Impact

Structured as a share account, the prize-based saving account can easily be implemented using most credit union’s data processing systems. We recommend using a separate product or share class code to facilitate tracking of funds in the account.

To determine the number of chances a member has to receive a prize, a data download of the eligible account holders can be transferred to an Excel spread sheet. A basic calculation to determine the number of chances a member has to win can be based on the structure determined by the credit union.

For example, if the credit union opts to offer a chance for each \$25 deposit made to the account, simply divided the balance in the account by 25 to determine the number of chances for that particular member. We recommend using the amount on deposit at the time the drawing is completed. A calculation using average daily balance could be used but may be difficult for the member to understand.

Once the calculation is complete, the member’s name or member number can be entered into a data base the appropriate number of times. Non-account holder entries can be added at this time. When the list is complete, a program can randomly select the prize winner(s).

This process will need to be followed each time the credit union holds a drawing. We recommend retaining the data records for each prize drawing should the process be audited or scrutinized.

Operational Considerations (continued)

Financial Projections

While return on investment is important, the total success of this program should not be measured in the return the credit union receives on funds deposited into a share account alone. Credit unions should also consider measuring success by the change in savings habits of participating consumers. Additionally, this product is designed to attract “un-banked” individuals who are paying significantly more for financial services through non-traditional providers.

As stated previously, much like other new product launches, the marketing expense should be considered an investment in the early stages and should be measured accordingly. Credit unions may also consider shifting interest expense to marketing expense when establishing the product pricing.

Included in the appendix section is a twelve-month projection of member activity based on the following assumptions. These assumptions represent *one* possible scenario to the many variables that may apply to your credit union and should be viewed as such.

Assumptions	
Average Deposit	\$100
Average Interest Rate	0.25%
Average # of New Deposit Accounts per month	150
Average Loan Rate	6.04%
Operating Costs (Annually)	0.30%
Annual Marketing Expense	\$6,000
Weekly Prize Expense	\$100
Monthly Prize Expense	\$1,000
Monthly Account Balance Increase	\$25

Summary

The prized-based savings account offers a unique and innovative way to encourage consumers to save. Low and moderate-income families can begin to build stronger, long-term savings habits. In addition, the credit union has an opportunity to attract deposits at a relatively low cost of funds. Isn't it time to reinvent the way we save?

Prize-based savings accounts—more interesting than interest.

Prize-based Savings Team

Filene Research Institute i3 Members

- ◆ Linda Brown, Executive VP, Service 1st FCU, PA.
brownl@service1.org
- ◆ Mark Forsyth, VP – Lending, National Institute of Health FCU, MD.
mforsyth@nihfcu.org
- ◆ Denise Gabel, VP – Strategic Direction, Spokane Teachers CU, WA.
deniseq@stcu.org
- ◆ Phil Smith, VP – Lending Strategies, Affinity Plus FCU, MN.
PSmith@affinityplus.org
- ◆ Darin Woinarowicz, VP – Development, Orange County Teachers CU, CA.
dwoinarowicz@octfcu.org

Harvard Business School Partners

- ◆ Peter Tufano, Sylvan C. Coleman Professor of Financial Management and Senior Associate Dean and Director of Faculty Development Harvard Business School, MA.
ptufano@hbs.edu
- ◆ Emily McClintock, Research Analyst, Harvard Business School, MA.
emcclintock@hbs.edu
- ◆ Daniel Schneider, Research Analyst, Harvard Business School, MA.

Appendix

I. Tax Implications for Members

- 1. Tax Burden - How prize winnings are taxed.** (It is important to note that prizes of low dollar value will likely have little material impact on a member's tax status. A survey of some of the more important tax ramifications follows.)

- a. Members will need to be aware that:**

Winnings from a prize based account are taxable. This is the case for cash winnings and for the fair market value of any non-cash prize. Depending on a member's total income and the amount of the winnings, a member's federal tax bracket can go as high as 39.6%.

Winnings may also be subject to state income tax. Depending on the state that a member lives in, the tax burden can exceed 50%. Members do not qualify for capital gains rate breaks for winnings, and there are no provisions for income averaging to help lower winnings based income.

- b. Reporting requirements:**

Members must report winnings income in the year, or years, the winnings are received. In the case of non-cash prizes, this would be the year the prize is received. In the case of cash winnings, the year you report the winnings would depend on whether the prize is payable in installments, or whether you are given the option to elect payment in a lump sum.

State regulations generally require cash or fair market value of prize earnings to be reported in the same year the winnings are received. Members will need to seek assistance regarding state regulations, as many requirements are different.

- c. Withholding:**

If a member wins more than \$5,000 in a prize, 28% must be withheld from winnings for federal income tax purposes. Members must receive a Form W-2G from the sponsoring credit union showing the amount of winnings paid during the year and the amount of federal income tax withheld. (This must also be sent to the IRS by the sponsoring credit union.)

If state income tax withholding is required, the amount of state income tax withheld may also be shown on Form W-2G.

- d. Other tax ramifications to be considered by members:**

1. Estimated taxes – if required
 2. Assignment of prize ticket – members who are sharing the winnings could still wind up paying tax on the entire amount, depending on the sharing arrangement.
 3. Other Federal and State requirements. Members may need the help of a qualified tax specialist.

II. Research Implications

In January 2006, a report entitled “Prize-based Savings: An Opportunity for U.S. Credit Unions” presented a new twist to a traditional savings account. It was prepared by Professor Peter Tufano and Research Associate Daniel Schneider from the Harvard Business School. The premise that consumers may be more motivated to save regularly if they have an opportunity to win a prize is at the heart of this savings opportunity.

Prize-linked accounts have been present in the U.K. since the 1950s. To date, no studies of this type of account are available in the United States. Credit unions have partnered with the Harvard School of Business to create a study on prize-based savings in the United States.

A study of member behavior and participation in a prize-based savings product will provide information of interest to policy makers, credit unions, and academics. Here are the questions the study intends to answer:

Policy Makers

- a) Do prize-based savings products attract low-income households?
- b) How much money is deposited by low income savers?
- c) Does participation in prize-based savings increase household savings?
- d) Is family well being positively affected?
- e) Does participation in prize-based savings reduce gambling behavior?
- f) Can the prize structure be used for asset building?

Credit Unions

- a) Is there a demand for prize-based savings products?
- b) What marketing and prize incentives are most effective?
- c) Does the introduction of prize-based savings cause internal cannibalization of existing products, and to what extent does this occur?
- d) How much do members save in the prize-based accounts, and is the savings behavior persistent?
- e) Is the use of prize-based savings products linked to long term loyalty?

Academics

- a) Does the framing of the prize share affect take-up?
- b) What type of customer uses the prize-based product?
- c) Do the product users demonstrate high risk tolerance? Are they different from other savings product users?
- d) Do the terms of the product affect usage?

Results of this study may change the structure of savings offerings for credit union and financial institutions at large in the future. Credit unions may solidify their ongoing commitment to serve people of modest means as well as gain recognition in financial circles as an innovator.