Workplace Savings

Helping E

By offering workplace emergency savings programs, employers can help workers better prepare for unexpected expenses or financial shocks.

benefits
MAGAZINE

Emergency Programs:

mployees Save for a Rainy Day

by | **Kevin Boyles**

Few events communicate the importance of workplace emergency savings funds as eloquently as the coronavirus pandemic. Quarantines, unpaid sick leave, reduced workhours, business closings and layoffs are creating financial issues for many people in the United States. Some households have emergency savings to help them cope with virus-related financial shocks, including medical bills. Many do not.

More than half (53%) of U.S. households have no emergency savings fund, according to a 2019 AARP Public Policy Institute report.[1] As a result, Americans must find other ways to cover expenses after a financial surprise. Some rely on credit cards, commercial loans, and family and/or peer borrowing to meet unexpected expenses. Others may tap retirement savings and/or sell investments (sometimes in unfavorable market conditions).

Employers have an opportunity to help workers become better prepared for whatever the future may hold by designing and implementing effective workplace emergency savings programs.

Employee Perceptions

Emergency savings accounts can improve employees' financial security. Catherine Harvey of the AARP Public Policy Institute reported that employees who have savings set aside to meet financial challenges are two-and-a-half times more confident about their financial futures than employees who do not have savings. The finding supports the idea that employers should consider including emergency savings programs in their financial wellness programs.

In the late 2018 *Saving at Work for a Rainy Day: Results from a National Survey of Employees,* Harvey and her coauthors found that a majority of employees (71%) were interested and likely to enroll in a payroll deduction emergency savings program if their employer offered one.[2] Those same employees identified the following features as important when considering emergency savings.

- Ability to withdraw savings quickly
- Flexibility to change or stop contributions at any time
- Portability to allow employees to keep their accounts when changing employers
- Privacy
- Low risk

When employer matching contributions were part of the package, 87% of those surveyed were interested in participating.

Emergency Savings Funds May Improve Retirement Outcomes

When workers are financially secure, employers reap a myriad of benefits, including improved engagement, productivity and retention. That may explain why the number of companies offering financial wellness programs doubled during the past four years. According to the *2019 Workplace Benefits Report* from Bank of America, the percentage of firms offering financial wellness programs was 53% in 2019, more than double the percentage in 2015.[3]

While the components of financial wellness programs vary from employer to employer, workplace emergency savings funds are likely to become an important feature of many plans. In addition to helping build employees' financial confidence, emergency savings accounts have the potential to improve retirement outcomes by reducing the need for participants to take plan loans and/or early distributions to cover unexpected expenses.

Research into plan leakage shows that employees often confuse retirement savings with emergency savings. Harvey of AARP explained:

> One survey found that 49 percent of employees expect that they will tap their retirement savings for a nonretirement expense. Indeed, 21 percent of loans from retirement accounts are taken to cover a financial emergency . . . Altogether, the toll of early withdrawals, and to a lesser extent loans from 401(k) plans and IRAs, is 20 percent lower aggregate retirement savings in the defined contribution retirement system.

Education

To improve retirement outcomes, plan participants will need to be educated on the importance of emergency savings. In general, education programs should have three key goals. First, they must clearly communicate the difference between retirement savings and emergency savings. Second, they must help workers understand why it's important to have emergency savings. And third, education should drive participation.

By offering opportunities to save in different accounts (one labeled as emergency savings and another labeled retirement savings), employers help employees begin to think differently about their savings. Education programs can emphasize these differences by clearly explaining the purpose of each account and the circumstances for when the assets should be used. In general, these programs may want to answer questions such as:

- What is an emergency savings account?
- Why do employees need emergency savings?
- What is or is not an emergency?

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Steve Vernon. 2018. Rest-of-Life Communications.
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- How much should employees save in emergency accounts?
- Why shouldn't retirement savings be used for emergencies?
- When should I use my retirement savings?
- How do employees enroll?
- Where do contributions go?
- How do participants access emergency accounts?
- How long will it take to receive the money?
- Who controls the account?

An effective way to communicate with employees about emergency saving is to create supporting digital and paper communications with messages that echo the education program. According to Harvey, messages that resonate with workers will emphasize financial stress reduction as well as program features like account access, privacy and control.

Furthermore, it will be important to compare and contrast emergency savings and retirement accounts. When people assign distinct mental labels to each account, they may be reluctant to use money in these accounts for reasons other than those suggested by the label.

takeaways

- More than half (53%) of U.S. households have no emergency savings fund.
- In addition to helping build employees' financial confidence, emergency savings accounts offered as part of workplace financial wellness programs can improve retirement outcomes by reducing the need for participants to take plan loans and/or early distributions to cover unexpected expenses.
- Features that employees seek in emergency savings accounts include the ability to withdraw savings quickly, flexibility to change or stop contributions at any time, portability to allow them to keep their accounts when changing employers, privacy and a low amount of risk.
- Possible account designs include payroll deduction savings accounts or individual retirement accounts (IRAs), payroll deduction Roth IRAs and repurposed retirement accounts.

Program Design

The emergency savings solution that best suits a particular company will depend on the company's organizational and benefits objectives as well as corporate culture and demographics. A National Bureau of Economic Research (NBER) paper,[4] written by John Beshears and several co-authors, described the pros and cons of several possible options, including the following.

Payroll Deduction Savings Accounts

Employers that implement payroll deduction savings accounts make it possible for employees to have a portion of their after-tax pay directed to savings accounts that employees have opened at banks, credit unions or other financial institutions. These accounts are advantageous because they are:

- Designed specifically for short-term saving
- Controlled by employees
- Protected by Federal Deposit Insurance Corporation (FDIC) insurance.

In addition, there is no limit on contribution amounts, and employees can access their savings at any time. Easy access is a double-edged feature. While it's essential that emergency funds be accessible, accounts of this type provide employees with little incentive to preserve their savings for emergencies, especially if *stored-value cards,* which are a type of electronic bank card for employees who do not have accounts with financial institutions, are used.

Employers can find ways to influence saving and spending behaviors. As mentioned previously, education can help employees understand the importance of emergency savings as well as the reasons not to use emergency savings to pay everyday expenses, take vacations or buy something unassociated with an emergency.

Cash offers also provide incentives that encourage participation in emergency savings and encourage participants to leave their savings untouched unless an emergency occurs. Levi Strauss created a savings program that offers a cash incentive. CBS News reported the program is available to 1,300 hourly workers and offers a dollar-for-dollar match of up to $240 over six months.[5] In other words, an employee who saved $40 a month had the opportunity to receive the full incentive amount. On average, participating employees saved about $700 in six months,[6] significantly more than needed to receive the full cash matching offer.

When an employer's goal is to provide a benefit that is relatively simple to implement and administer, payroll deduction savings accounts may be a good choice, especially when the solution includes education and/or a cash offer. If a cash offer is not an option, employers may want to consider a

solution that deters unnecessary withdrawals through taxation of earnings distributions.

Payroll Deduction Roth IRAs

Payroll deduction Roth IRAs may be a sound alternative for employers that do not want to match contributions to emergency savings accounts. Similar to payroll deduction savings accounts, Roth IRA savings programs are relatively simple to implement and administer. Employers make it possible for employees to have a portion of their after-tax pay directed to a Roth IRA that employees open. These accounts may be advantageous because they are:

- Tax-advantaged savings opportunities
- Controlled by employees
- Portable when employees change jobs.

Roth IRAs offer significant liquidity with enough tax consequences to make employees think carefully before taking a distribution. Unlike contributions to a Roth 401(k) plan account, any contributions made to a Roth IRA can be distributed tax-free and penalty-free. However, any earnings in a Roth IRA may be subject to early withdrawal penalties and taxes, unless certain requirements are met. The friction created by tax penalties on earnings may help deter unnecessary withdrawals.

In addition, IRA owners must request withdrawals. The brief delay before assets are distributed may help prevent nonemergency spending so the money is available when emergencies occur.

An additional benefit of the Roth IRA structure is that it may help improve retirement outcomes. Accumulated savings that are not spent on emergencies can be used for retirement in the future.

One possible disadvantage of this solution is that Roth IRAs have contribution and income limits. The annual Roth IRA contribution limit for 2020 is $6,000. While this may be a larger amount than many workers choose to set aside in an emergency account, for high-income earners, the limit may be lower than preferred. In addition, employees who file taxes individually must earn less than $124,000 to make a full contribution to a Roth IRA. Those who are married and filing jointly must have earnings of less than $196,000.

Payroll deduction savings accounts and Roth IRAs may be attractive options for smaller employers that are adopting payroll deduction retirement plan solutions. As mentioned previously, implementing both types of accounts simultaneously can help employees clearly delineate between the two.

Repurposed Retirement Accounts

Another solution is to repurpose qualified retirement plan accounts by adapting after-tax contribution accounts or establishing deemed IRA accounts. These options may be advantageous because they:

- Are tax-advantaged savings opportunities
- Are controlled by the employer
- May allow matching employer contributions.

Many 401(k) plans have provisions that allow participants to make vol-

Coronavirus, Medical Expenses and Emergency Savings

Prior to the coronavirus crisis, emergency savings funds (to cover expenses like medical bills, car repairs or job loss) were becoming a hot topic of conversation among benefits professionals. The global pandemic and its impact on the economy has shined a spotlight on the need for emergency savings. Coronavirus-related business closures have left millions of people struggling to make ends meet. Some are stretching unemployment benefits, emergency savings and even retirement savings to cover monthly expenses; others are incurring significant medical bills as they fight for their lives.

In mid-March, the Kaiser Family Foundation estimated that treatment costs could top $20,000 for coronavirus patients with complications or comorbidities, and average out-of-pocket costs could exceed $1,300 for all admitted patients, including those without complications or comorbidities.*

In addition, Kaiser indicated there is a significant likelihood that some COVID-19 patients will incur unexpected out-of-network charges.

As employers reopen, many employees will return to work with empty savings accounts and a new understanding of financial insecurity. Ultimately, employees of all different backgrounds will likely have a new perspective on emergency savings.

*See www.kff.org/health-costs/issue-brief/potential-costs-of-coronavirus-treatment-for-people-with-employer-coverage/.

untary after-tax plan contributions. Relatively few participants take advantage of the option; however, some plans use the accounts for special purposes such as recharacterizing plan contributions to meet nondiscrimination rules. Typically, after-tax contributions are not subject to the contribution and distribution restrictions that apply to traditional and Roth plan account distributions, so contributions can be distributed without taxes or penalties. Similar to Roth IRAs, any pretax earnings distributed may be subject to taxes and penalties. Unlike Roth IRAs, any earnings must be distributed as part of an after-tax withdrawal.

Deemed IRAs also can be incorporated into qualified retirement plans, and they are accounted for separately just as after-tax accounts are. A key difference is that deemed IRAs are not subject to qualified plan rules. The accounts are treated like regular IRAs and subject to the same contribution and income limits. Similar to Roth IRAs, contributions can be withdrawn tax- and penalty-free at any time and for any purpose. Earnings distributions typically are subject to taxes and penalties.

When emergency savings account solutions are structured as a component of a qualified plan, automatic enrollment and matching contributions may be possible. While the features confer a significant advantage that can help ensure the success of these programs, there are disadvantages. For instance, emergency savings accounts that are part of qualified plans may increase the administrative and fiduciary complexity of the plans. In addition, some employees may object to emergency savings funds if they believe employers are intruding in their financial lives.

A final disadvantage is that these solutions do not distinguish a difference between retirement savings and emergency savings. Consequently, employers will need to communicate the benefits differently. Emergency savings accounts that are part of tax-advantaged retirement plans will help participants save for emergencies, and any funds not needed for emergencies can be spent in retirement.

Emergency Savings Funds and Financial Wellness

A February 2020 Employee Benefits Research Institute (EBRI) *Issue Brief* reported that 13% of emergency-fund-focused employers currently offer a payroll deduction emergency savings vehicle, 19% anticipate offering one in the next year or two, and 29% are interested in learning more.[7] Ultimately, implementing emergency savings solutions can help employers build employees' financial confidence and reduce financial stress. When employees don't suffer from financial stress, they tend to be more engaged and productive and turnover drops.

Another benefit of emergency savings funds that should not be overlooked is that they may protect retirement savings. Currently, a significant percentage of working Americans seem to consider their retirement savings to be emergency savings. If our goal is to improve retirement outcomes and ensure the retirement security of Americans, emergency savings funds represent an important step in the right direction.

bio

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Endnotes

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