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Record Keepers' Role in Solving the U.S. Emergency Savings Crisis

November 2020

Acknowledgements

Thank you to Commonwealth staff members who wrote this report and provided the associated analysis: Sylvia Brown, Nick Maynard, and Catherine Wright.

Commonwealth is a national nonprofit building financial security and opportunity for financially vulnerable people through innovation and partnerships. For nearly two decades, Commonwealth has designed effective innovations, developing private- and public-sector partnerships to scale solutions and policies enabling 750,000 people to accumulate more than $3 billion in savings. Commonwealth understands that broad changes require market players to act. That's why we collaborate with consumers, the financial services industry, fintechs, employers, policymakers, and mission-driven organizations. The solutions we build are grounded in real life, based on our deep understanding of people who are financially vulnerable and how businesses can best serve them. To learn more, visit us at www.buildcommonwealth.org.

BlackRock's Emergency Savings Initiative

This report is made possible thanks to the generous support of BlackRock's Emergency Savings Initiative. BlackRock has announced a $50 million philanthropic commitment to help people living on low- to moderate incomes gain access to and increase usage of proven savings strategies and tools to help them establish an important safety net. Led by its Social Impact team, BlackRock, along with nonprofit experts known for their innovative approach to consumer finance: Commonwealth, Common Cents Lab, and Financial Health Network (formerly CFSI) are working to address the savings crisis and fuel the future of savings innovation.

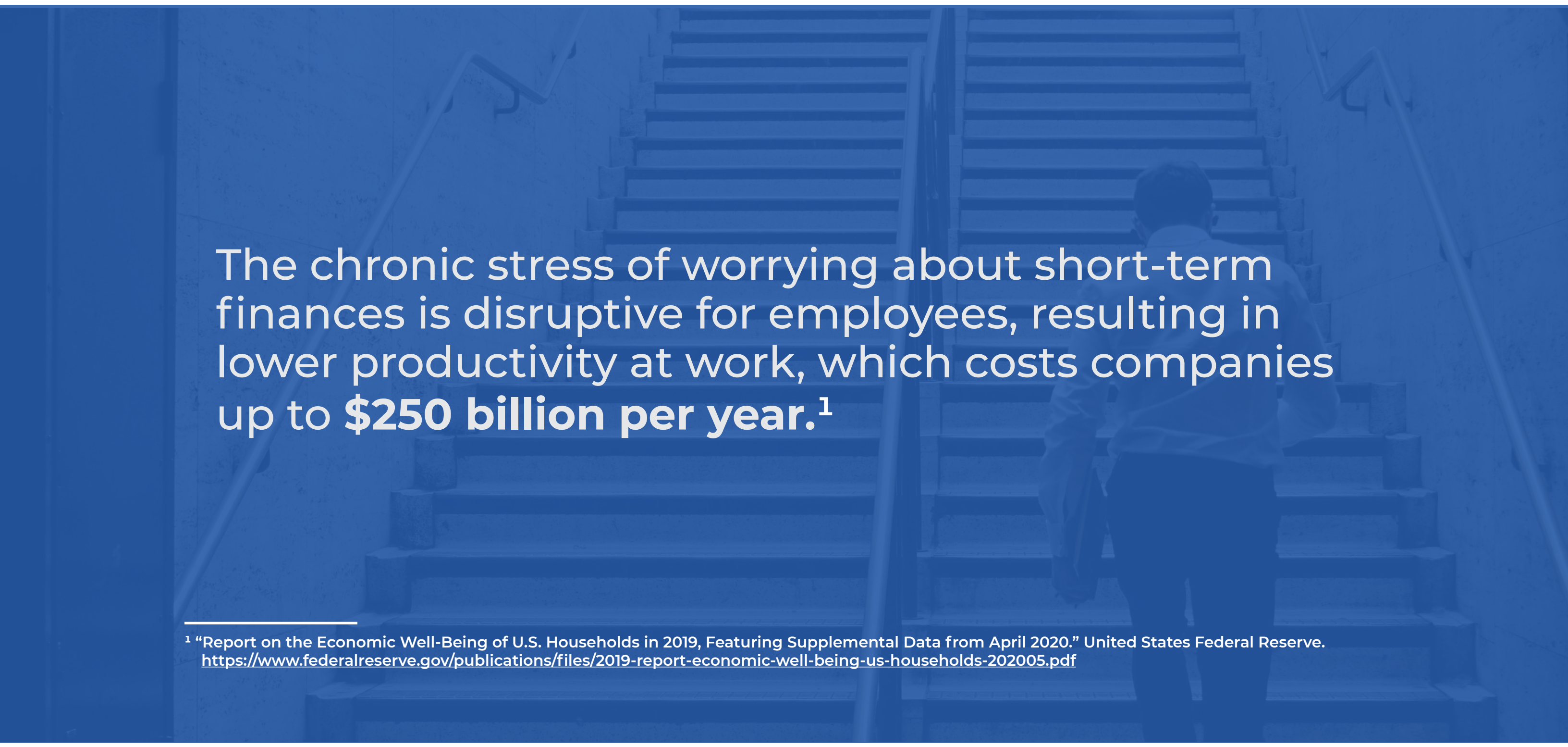
Thanks also to DCIIA and Warren Cormier, Director of the Retirement Research Center at DCIIA, for his thoughtful collaboration on surveys to understand how low- to-moderate income plan participants are weathering COVID-19. Findings from our joint research are included in this report.

Executive Summary

Employers and record keepers can play a key role in improving the financial security of U.S. workers through initiatives that enable short-term, liquid savings. With [37% of Americans unable to manage a $400 emergency with savings], and lower-income households, women, and Black households disproportionately affected, the issue of emergency savings is an urgent one for much of America.

The chronic stress associated with worrying about short-term finances is disruptive for employees, resulting in lower productivity at work, which costs companies up to [$250 billion per year]. Those employees who have retirement savings often use them as de facto emergency funds, further disrupting their long-term financial goals.

Addressing the issue of short-term savings has benefits not only for workers, but for employers and record keepers alike. Employers and record keepers who partner to provide accessible savings vehicles for employees can increase employee engagement, strengthen existing benefits programs, increase employee savings rates, and reduce early retirement withdrawals.



The chronic stress of worrying about short-term finances is disruptive for employees, resulting in lower productivity at work, which costs companies up to **$250 billion per year.**[1]

[1] "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020." United States Federal Reserve. https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf

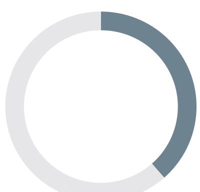
A Lack of Emergency Savings

Lower- and moderate-income Americans lack emergency savings—in part because they lack access to high-quality, liquid savings vehicles.

Financial insecurity is a widespread problem, particularly for lower- and moderate-income (LMI) Americans. According to the Federal Reserve, 37% of all Americans do not have $400 in savings for an emergency. The impact is more significant for households making under $60,000 (58%); and among those households, the percentage is even greater for women (61%), Hispanic households (69%), and Black households (71%).

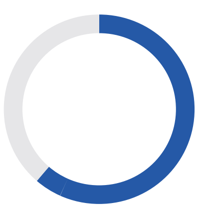
LMI households also tend to experience income volatility—an issue that emergency savings can address by providing a reserve of cash that can be drawn down and built back up as needed depending on cash flow.

Lack of access to effective savings vehicles is a significant barrier to building liquid savings. Fewer than half of LMI households hold traditional savings or money market accounts, with reasons ranging from low availability of such accounts in their communities to high fees.



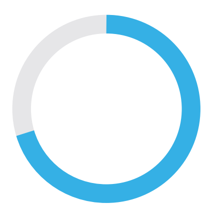
37% of Americans do not have $400 in savings for an emergency.[2]

Populations that are more likely to lack $400 or more in emergency savings:



61% of women making under $60k

58% of households making under $60k



71% of Black households making under $60k

[2] "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020." United States Federal Reserve. https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf

Consequences for Employers, Record Keepers, and the Economy

Financial insecurity is a costly problem that has far-reaching consequences, not just for workers, but for businesses and ultimately our society as a whole. By one estimate, employee financial stress costs employers $250 billion per year.

Financial insecurity also leads to reduced 401(k) participation by employees, as well as increased 401(k) loans and hardship withdrawals for participants. During financial emergencies, many people are driven to tapping retirement funds as de facto emergency savings. Reducing these emergency withdrawals is key to the long-term financial security of people living in the United States. Withdrawing money from retirement funds can have a tremendous opportunity cost. In 2019, 41% of households headed by a person aged 35 to 64 were projected to run out of money during retirement.

COVID-19 Emergency Savings Needs

The lack of emergency savings is an endemic problem for Americans. At the start of the COVID-19 crisis, fewer than half of Americans said they had enough emergency savings to last them three months. The numbers were worse for Black and Latinx households, where fewer than 30% had a three-month emergency fund.

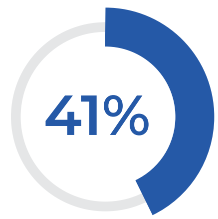
Recent research from Commonwealth and DCIIA's Retirement Research Center demonstrated that employees with little to no liquid savings were more likely to take a negative action in their retirement account, such as pausing their contributions or taking an early withdrawal or loan.

[3] Vanderhei, Jack. "Retirement Savings Shortfalls: Evidence From EBRI's 2019 Retirement Security Projection Model®." EBRI. https://www.ebri.org/content/retirement-savings-shortfalls-evidence-from-ebri-s-2019-retirement-security-projection-model

[4] Brown, Sylvia; Cormier, Warren; Maynard, Nick. "Saving Through a Crisis: How LMI Retirement Plan Participants Are Weathering COVID-19." Commonwealth. https://buildcommonwealth.org/blog/post/saving-through-a-crisis-how-lmi-retirement-plan-participants-are-weathering-covid-19

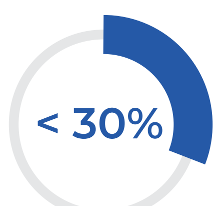
[5] Brown, Anna; Horowitz, Juliana Menasce; Parker, Kim. "About Half of Lower-Income Americans Report Household Job or Wage Loss Due to COVID-19." Pew Research Center. https://www.pewsocialtrends.org/2020/04/21/about-half-of-lower-income-americans-report-household-job-or-wage-loss-due-to-covid-19/

During financial emergencies, many people are driven to tap retirement funds as de facto emergency savings. **Reducing these emergency withdrawals is key to the long-term financial health of Americans.**



41% of households headed by a person aged 35 to 64 were **projected to run out of money during retirement** as of 2019.[3]

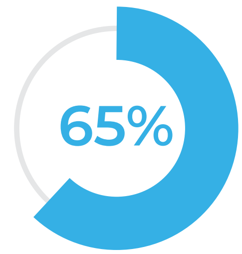
Recent research from Commonwealth and DCIIA's Retirement Research Center demonstrated that **employees with little to no liquid savings were more likely to take a negative action, such as an early withdrawal, on their retirement accounts.**[4]



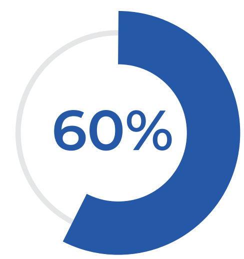
Less than 30% of Black and Latinx households had a three-month emergency fund at the start of the COVID-19 crisis.[5]

The Role of Employers and Record Keepers

Employers and record keepers are uniquely positioned to enable employee financial security—and employees seek and appreciate employer-based financial tools and opportunities to save.



65% of respondents said **employers should be doing more to help** with financial security.[6]



60% said they believed **institutions would be better off if they helped people experiencing financial vulnerability.**[6]

Employees Seek Solutions from Employers

It's no surprise that employees believe that the companies from which they earn their living play a major role in their financial security. But that role goes beyond a paycheck: employees seek a suite of financial tools from employers. In a national survey of working Americans, Commonwealth found that 65% of respondents said that employers should be doing more to help with financial security, and 60% said that they believed institutions—including employers—would be better off if they helped people experiencing financial vulnerability.

Employees are eager to follow the lead of their employers. In an AARP survey, more than 7 in 10 workers said they would be likely to participate in a payroll-deduction rainy day savings program if their employer offered one. Employees reported increased savings and reduced stress as the main reasons for their interest in such programs.

Record Keepers are Uniquely Positioned to Enable Savings

Traditionally, employer savings programs focused on retirement saving through defined benefit or defined contribution plans. This focus puts record keepers in a prime position to provide other emergency savings vehicles for employees in a seamless way—given that record keepers have technology and infrastructure in place already. Their platforms already allow for auto-enrollment and paycheck deduction, both critical for addressing enrollment and technology requirements that may be major stumbling blocks for other would-be providers of workplace emergency savings products.

Furthermore, record keepers' recent move toward providing more financial wellness tools, such as student loan repayment products, makes an emergency savings tool a natural extension of the existing offerings. Many already offer financial wellness assessments to understand employees' emergency savings needs. Adding an option to build emergency savings within their own platform is a logical next step.

Working across multiple employers, record keepers are well-positioned to help solve the emergency savings problem by reaching many sets of employees at once.

[6] Rotondo, Stephanie. "Employees' Financial Stress Costs Employers." World At Work. https://www.worldatwork.org/workspan/articles/employees-financial-stress-costs-employers

Commonwealth Partnered with UPS and Voya to Achieve an Emergency Savings Milestone

With the program, UPS becomes "one of the largest U.S. employers to join a trend that reflects concern over the impact of workers' financial problems on their ability to retire." - The Wall Street Journal

UPS announced the launch of an emergency savings program that provides 90,000 US-based non-union employees a way to set aside liquid after-tax savings easily and automatically as part of their 401(k) retirement plan administered by Voya Financial—a critical boost to employee financial security in the midst of the pandemic. UPS, which joined BlackRock's Emergency Savings Initiative in 2019, collaborated closely with Commonwealth to design and implement the program. Read more here about how Commonwealth partnered with UPS and Voya to achieve this emergency savings milestone.

Benefits to Employers

An opportunity to combine good business practices with doing good.

More Financially Secure Employees are More Loyal, Productive Employees

Financially secure employees are less stressed, more productive, and more loyal.

One study found that employees spend an average of 13 hours a month at work worrying about finances. The COVID-19 crisis is exacerbating this issue, as nearly half of Americans report that their mental health has been negatively impacted by financial stress due to the pandemic.

Financially stressed employees are more likely to seek employment elsewhere, costing employers an added 11% to 14% of their payroll expense in turnover costs, either because the complications of financial vulnerability make holding a position difficult, or to seek out higher wages and greater opportunity elsewhere.

Employer-sponsored savings programs are particularly beneficial for LMI employees. In a Commonwealth study, lower-income employees reported that employer financial wellness interventions (such as savings tools) at the time of a raise would reduce their stress (74%), enhance their productivity (62%), and increase their likelihood of staying with the company (76%).

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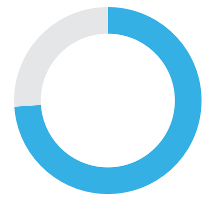
74%
reduce stress

62%
encourage productivity



74%
increase likelihood of staying with the company

A Moral Imperative Combined with a Business Benefit

Emergency savings tools provided as part of an employee's benefits package meet the needs and demands of workers, fostering a more financially secure—and therefore stronger—workforce.

There has been increased pressure on business leaders to operate for the benefit of all stakeholders, not just shareholders, and that includes employees. Companies that prioritize environmental, social, and corporate governance (ESG) metrics—including the way they treat their workers—outperformed their peers during the economic downturn caused by COVID-19. Worker financial security—part of the "S" in ESG—is not only a moral obligation for employers, but also a business one.

The disruption of COVID-19 has been a call to action for employers to address the financial well-being of their workforce. Most private sector leaders recognize that the trends in wealth disparity should not continue in the direction that they are headed. Private sector leadership is critically needed to meet the need for quality emergency savings products.

Companies that prioritize **environmental, social, and corporate governance outperformed their peers** during the economic downturn at the start of the pandemic.[8]

Financially stressed employees are **two times** more likely to seek employment elsewhere, **costing employers an added 11% to 14%** of their payroll expense in turnover costs.[9]

[7] "Rise with the Raise: Employer Benefits for Building Lower-Wage Employee Financial Security." Commonwealth. https://buildcommonwealth.org/assets/downloads/Rise_with_the_Raise_Visual.pdf
[8] Bixby, Steffen; Mahoney, Charlie. "JUST Chart of the Week: Companies Most Dedicated to Their Stakeholders Have Outperformed the Market During the Coronavirus Crisis." JUST Capital. https://justcapital.com/news/companies-most-dedicated-to-their-stakeholders-have-outperformed-the-market-during-the-coronavirus-crisis/
[9] Rotondo, Stephanie. "Employees' Financial Stress Costs Employers." World at Work. https://www.worldatwork.org/workspan/articles/employees-financial-stress-costs-employers

Benefits to Record Keepers

By offering emergency savings products on their platforms, record keepers can gain a competitive edge and increase engagement with current or potential plan participants.

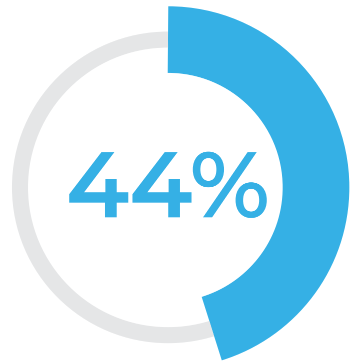
Meeting Employer Needs by Offering Emergency Savings Solutions

With workplace emergency savings tools, record keepers meet employer demand for more holistic financial security offerings. An EBRI study found that 44% of employers said they either offer or plan to offer an emergency savings program.

Engagement with Employees

Record keepers can improve participant engagement by adding an emergency savings product to their financial wellness platforms. Increasing employees' engagement with the platform may make them more likely to open new accounts and invest in proprietary ETFs, and less likely to move funds out of the account upon switching employers.

These tools can increase plan participation among LMI employees in particular. LMI employees are less likely to participate in 401(k) plans, so offering emergency savings solutions gives record keepers an opportunity to engage employees who are not making pre-tax contributions. These employees also often face income volatility and need to reach some level of financial stability before they can consider participating in longer-term savings options, such as retirement plans.



44% of employers said they either offer or plan to offer an emergency savings program.[10]

Employees with lower balances in nonretirement accounts **are more likely to say** they would enroll in a payroll-deduction rainy day savings program.[11]

[10] "EBRI Finds Emergency Fund Assistance is High on Employers' Priority List for Employees' Financial Wellbeing." EBRI. https://www.ebri.org/docs/default-source/ebri-press-release/pr-1262-emergencysavingshelp-13feb20.pdf?sfvrsn=e0713d2f_4

[11] Brown, S. Kathi. "Saving at Work for a Rainy Day: Results from a National Survey of Employees." AARP. https://www.aarp.org/content/dam/aarp/ppi/2018/09/rainy-day-national-survey.pdf

Such participants are also more likely to want to enroll in emergency savings vehicles: employees with lower balances in nonretirement accounts are more likely to say they would enroll in a payroll-deduction rainy day savings program. The same study found that employees with lower confidence in their ability to pay for a $2,000 expense without tapping their retirement accounts are somewhat more likely to participate in employer-sponsored rainy day savings programs.

Reduced Hardship Withdrawals and Loans

Offering emergency savings solutions can also help reduce hardship withdrawals and loans. Commonwealth and the Defined Contribution Institutional Investment Association (DCIIA)'s research shows that having little or no liquid savings increases the likelihood that participants will take a negative action in their retirement savings. While few people had taken hardship withdrawals at the start of the pandemic, many LMI plan participants reduced expenses (70%) and turned to credit cards (15%).

Early 401(k) withdrawals have increasingly become a major issue: a 2018 E-Trade Financial report indicated that the percent of people who withdrew from their 401(k) plans has doubled since 2015. The 2018 Bipartisan Budget Act has accelerated this trend, with some record keepers estimating a 40% increase in 401(k) withdrawals in the first few months of 2019. Furthermore, CARES Act provisions enable penalty-free retirement withdrawals, which could increase the number of hardship withdrawals in coming months. If employees have more liquid funds to draw on in the case of unexpected expenses or income volatility, they are less likely to tap their retirement funds.

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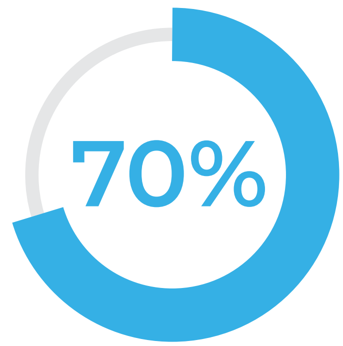

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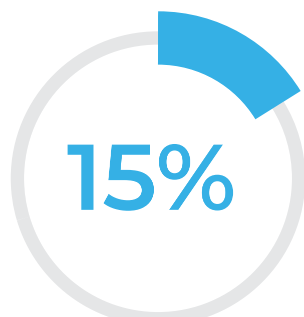

15% turned to credit cards to meet expenses.[12]

[12] Brown, Sylvia; Cormier, Warren; Maynard, Nick. "Saving Through a Crisis: How LMI Retirement Plan Participants Are Weathering COVID-19." Commonwealth. https://buildcommonwealth.org/blog/post/saving-through-a-crisis-how-lmi-retirement-plan-participants-are-weathering-covid-19

Qualities of an Effective Emergency Savings Program

Options vary, but highly liquid, portable savings vehicles with clear messaging are key.

Choosing the Right Approach

Record keeper emergency savings tools can take a variety of forms. One example is an in-plan account within an employee's retirement plan, set up through after-tax or deemed Roth IRA contributions along with modifications to better accommodate liquid savings. Record keepers could also provide a separate out-of-plan emergency savings solution (i.e., retirement adjacent), where a record keeper either builds or acquires a new solution or partners with a fintech or financial institution that provides a liquid savings tool, potentially as part of a broader financial wellness program. Employers and record keepers should work closely together to determine the approach that is best for their employees based on the features of in- and after-tax emergency savings solutions.

Targeting Financially Vulnerable Employees

Emergency savings offerings should be targeted toward financially vulnerable employees. Lower-income workers are less likely to participate in retirement plans, even when they are offered, because they tend to benefit less from the tax-deferred nature of retirement plans (due to their lower tax rate) or the plans are ill-suited to their financial needs (e.g., the accounts are too illiquid, they lack the slack in their budgets to contribute to long-term savings). So while these workers might have access to retirement plans, they may face greater barriers to saving money in those plans.

Design Choices and Incentives

Employers should also consider design choices and incentives that improve engagement and usage, such as providing seed money into the account, gamification, or even matching contributions. One proven example is prize-linked savings, or providing an incentive to save by linking savings behavior to chances to win a prize. This innovation has been demonstrated at scale through Walmart's Prize Savings program, which helped customers save over $2 billion.

Messaging that Promotes a Financial Security Mindset

Messaging is also critical. It should promote or advance a financial security mindset—positioning financial security as a journey, emphasizing agency, and presenting attainable aspirations. Messaging should be segmented and designed for different groups, including 401(k) participants, nonparticipants, and employees who do not qualify for the 401(k) but have access to the emergency savings benefit.

Record keepers developing emergency savings solutions should focus on financial stability first. Messaging should distinguish retirement savings from short-term savings—a significant change from a focus on long-term savings only.

Qualities of a Good Emergency Savings Vehicle

A high-quality emergency savings product also has a few key features. According to an AARP study, employees want to be able to access their money immediately, start or stop contributing, keep the account if they leave their job, and maintain privacy. Commonwealth's research on emergency savings products highlights many of these features and finds that a good emergency savings vehicle is:

- Liquid—contributions can be withdrawn quickly and easily
- Portable—easily transferred to a new employer or when an individual leaves the workforce
- Principal-protected—an employee's contributions will not lose their value
- Low- or no-fee—having no withdrawal, maintenance, or other fees increases uptake of the account and increases trust in the financial institution providing the solution
- Transparent—terms and conditions are clearly communicated

Record Keeper Emergency Savings Products

Record keepers can help plan participants build a financial cushion by offering highly liquid emergency savings solutions structured either in-plan or out-of-plan. Learn about three emergency savings products currently available to employers with varying levels of integration with retirement platforms.

The Moment to Act

Moments like the current economic crisis shine a spotlight on the longstanding inequities in our financial system, and the effective role that institutions such as employers and record keepers can play in enabling financial security. By providing high-quality emergency savings programs tailored to financially vulnerable employees, employers and record keepers can improve financial security while adding business value—positively impacting the workforce and increasing engagement for record keepers.

To learn more about offering emergency savings solutions through your retirement plan platform, contact Nick Maynard, Senior Vice President and Catherine Wright, Senior Innovation Manager at info@buildcommonwealth.org.

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