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Eye on Systemic Change in the Retirement Industry:

How Recordkeepers are Leading the Charge to Address the Emergency Savings Crisis

Acknowledgements

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BlackRock's Emergency Savings Initiative

BlackRock announced a philanthropic commitment to help millions of people living on low to moderate incomes gain access to and increase usage of proven savings strategies and tools – ultimately helping them establish an important safety net. The size and scale of the savings problem requires the knowledge and expertise of established industry experts that are recognized leaders in savings research and interventions on an individual and corporate level. Led by its Social Impact team, BlackRock is partnering with innovative industry experts Common Cents Lab, Commonwealth, and the Financial Health Network to give the initiative a comprehensive and multilayered approach to address the savings crisis. Payroll providers, recordkeepers, employers and fintechs have joined BlackRock's Emergency Savings Initiative to help their employees and customers take the essential first step toward long-term financial well-being. To learn more about BlackRock's Emergency Savings Initiative, visit www.savingsproject.org.

Executive Summary

With 37% of Americans unable to manage a $400 emergency using savings—and lower-income households, particularly Black and female-led households disproportionately affected—the issue of emergency savings is an urgent one for much of America. Retirement plan recordkeepers are acutely aware of this crisis and are well-positioned to play a pivotal role in addressing it. As recordkeepers recognize that many plan participants cannot cover the costs of short-term emergencies, let alone prepare for financially stable retirement, they are acting on this issue.

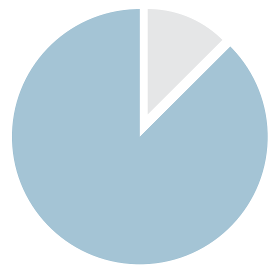
To capture and share insights from the retirement industry on offering workplace emergency savings products, Commonwealth and DCIIA's Retirement Research Center (RRC) have conducted quantitative and qualitative research on emergency savings in the retirement industry. This report summarizes a series of interviews with nine of the largest recordkeepers in the United States and seven plan sponsors. Eight of the nine recordkeepers we interviewed either offer or are planning to offer an emergency savings product.

Several recordkeepers and plan sponsors noted special focus on low- and moderate-income (LMI) employees in building and evaluating emergency savings products, with the aim of enabling LMI employees to increase financial security and avoid taking on high-cost debt or tapping retirement savings.

As insights from our interviews demonstrate, it is no longer a matter of "if" but rather "how" and "when" recordkeepers will offer emergency savings products. This report dives into the "what" (definition of emergency savings), the "how" (in-plan vs. out-of-plan and go-to-market strategy), and the "when" of launching emergency savings offerings.

The emergency savings crisis has only been exacerbated by COVID-19; therefore, it is even more important today that recordkeepers develop emergency savings solutions as soon as possible. And, critically, recordkeepers should be focusing on LMI employees most in need of an affordable, accessible solution.

This report summarizes a series of interviews with **nine of the largest recordkeepers in the United States and seven plan sponsors.**



8 out of 9 recordkeepers we interviewed either offer or are planning to offer an emergency savings product.

Key Findings

As insights from our interviews demonstrate, it is no longer a matter of "if," but rather "what," "how," and "when" recordkeepers will offer emergency savings products.

What:

- Recordkeepers recognize the need for employee access to quality emergency savings products. To address this need, all except one of the recordkeepers we interviewed either offer or are planning to offer an in-plan or out-of-plan emergency savings product.
- There is currently no common definition of emergency savings among the largest recordkeepers. We recommend Vanguard's two-tiered definition to cover expense and income shocks.
- With a few notable exceptions, most recordkeepers did not discuss plans to address the unique challenges that LMI employees face in saving for emergencies and retirement.

How & When:

- Based on our interviews, the majority of recordkeepers are leaning toward offering out-of-plan solutions, though several said they would offer both in-plan and out-of-plan solutions to meet plan participant and plan sponsor demand.
- Plan sponsors were split on their preference for in-plan vs. out-of-plan solutions.
- Whether leveraging an existing product, partnering with a third party, or building a new product in-house, recordkeepers should keep in mind plan sponsors' key considerations:
    - acting as a fiduciary for their employees,
    - employee engagement/utilization,
    - cost implications, and
    - limiting their total number of benefits vendors.
- Of the seven plan sponsors we interviewed, just over half plan to offer emergency savings in the near term, either through their recordkeeper or credit union.

Introduction

Retirement plan recordkeepers are increasingly recognizing and acting on the need to support employees' broader financial well-being as part of building retirement readiness. A foundational component of financial well-being is building and maintaining emergency 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.

With several recordkeepers already offering emergency savings products and several more planning to do so, the industry conversation has shifted from "if" to "how" and "when" recordkeepers will launch emergency savings solutions.

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

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

58% of households making under $60k

61% of women making under $60k

71% of Black households making under $60k

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.**

To dive deeper into the considerations for recordkeepers and plan sponsors to offer emergency savings products to employees across the United States, Commonwealth and DCIIA's Retirement Research Center (RRC) conducted primary research by conducting in-depth qualitative interviews.

Commonwealth and DCIIA's Retirement Research Center (RRC) interviewed nine of the largest recordkeepers in the United States to understand their plans and perspectives on offering emergency savings. Collectively, the recordkeepers we interviewed represent approximately 58 million plan participants, 170,000 plan sponsors, and $4.7 trillion in assets under management. Our interviewees were people employed by recordkeeping firms working closely with emergency savings product strategy with direct experience on financial wellness and innovation teams.

We also interviewed seven plan sponsors across a variety of industries to buttress our recordkeeper findings. The plan sponsors operate in a variety of sectors, from healthcare to technology to aerospace to food manufacturing. Collectively, the seven plan sponsors employ approximately 870,000 employees.

The insights from these plan sponsor interviews add important context for considering the market for offering emergency savings products as an employee benefit. Plan sponsor perspectives are critical because large plan sponsors typically pave the way for innovations in financial wellness and retirement saving plans. (Insights from both the recordkeepers and plan sponsors are shared anonymously in this report.)

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170,000 plan sponsors

$4.7 trillion in assets under management

The seven plan sponsors we interviewed:

employ **approximately 870,000 employees**

operate in a **variety of sectors from healthcare to technology to aerospace to food manufacturing**

The *What:* Recognizing and Defining the Need for Emergency Savings

The Need for Emergency Savings is Clear

Among recordkeepers, momentum is building: there is widespread recognition of the need for employee access to quality emergency savings products.

Although recordkeepers' primary objective is to support retirement savings, they increasingly understand that other aspects of a plan participant's financial life, including their preparedness for emergency expenses, are crucial to their ability to save for retirement. And research supports this conclusion: plan participants who have not saved for emergencies are twice as likely to tap their workplace retirement savings. During our interviews, several recordkeepers also shared that plan sponsors have increasingly expressed interest in recordkeeper-offered emergency savings tools, an accelerating trend they saw during COVID-19 (see callout box *COVID-19 Spotlighted the Need for Emergency Savings* on the next page).

> **"[Emergency savings is a] sleeper issue—everybody acknowledges that it's important. There is opportunity for disruption and innovation in product offerings."**
> *-Recordkeeper*
>
> **"[Emergency savings] is probably the first thing to be discussed with plan sponsors."**
> *-Recordkeeper*

Two recordkeepers emphasized that emergency savings products represented a shift in how recordkeepers saw their role in ensuring financial security for their participants. One said it took "more than a year" to be comfortable saying that emergency savings should come before retirement savings, but that they realized building emergency savings was a way to ensure that the retirement plan is not a "revolving door" of loans and withdrawals.

Another interviewee pointed out that in the retirement industry, "historically, asset allocation has always been the answer to everything," with focus on only "one aspect of the financial picture: retirement." Now the industry's focus is broadening to consider more aspects of financial wellness, including emergency savings.

Our plan sponsor interviews support the recordkeepers' observations: all interviewees recognized the critical role that building emergency savings plays in increasing employee financial security.

Notably, a plan sponsor with a majority of low- and moderate-income (LMI) employees emphasized the need to support their employees in building emergency savings so that they could avoid taking out employer loans or charging more to their credit cards:

> **"They're really just taking [loans] for this tiny, short-term thing, and they have to pay a fee… if you have emergency savings, you wouldn't immediately go to your credit cards. We're trying to help employees avoid [paying unnecessary fees]."**
> *-Recordkeeper*

COVID-19 Spotlighted the Need for Emergency Savings

Although most plan sponsors had considered emergency savings before the COVID-19 pandemic, the pandemic heightened the need and demand for short-term liquid savings.

> **"Emergency savings has been an important topic the last couple of years, but COVID has emphasized the need for it [particularly] with company layoffs and furloughs. This has made it easier to include [emergency savings] in conversations and communications with plan participants."**
> *-Recordkeeper*

For recordkeepers, the rates of retirement plan withdrawals to cover emergency expenses--coronavirus-related distributions (CRDs)--were not as high as they initially anticipated.

Recordkeepers reported about **5% of their plan participants taking CRDs,** with average withdrawals ranging from $12,000 to $28,000.

- One recordkeeper said that **"most people taking CRDs do not drop their savings rates, and in fact have increased them,"** perhaps indicating that they are "working toward paying it back."
- Two recordkeepers noted increased plan participant engagement due to the uncertainty brought on by COVID-19, as evidenced by high call volumes.
- One described their plan participants as having **"opened their eyes to the fact that they weren't prepared"** and are **"in a good spot right now to receive information and help."**
- Finally, several recordkeepers noted that the pandemic has accelerated already increasing interest in emergency savings products, **"reinforc[ing] the need for these products"** and leading to **"healthy conversation"** about what workplace emergency savings might look like.

Improve Retirement Readiness

Recordkeepers' primary goal in offering emergency savings solutions is to improve plan participant retirement readiness. The more that an emergency savings product can help reduce loans and withdrawals from the retirement account, the better. When we asked recordkeepers why they would offer emergency savings, over half of recordkeepers interviewed named that goal, with several naming it as their top goal.

> **"Ultimately, at [their] heart, [they] want to help people save and invest."**
> *- Recordkeeper*
>
> **"An emergency savings product would help participants realize the benefit of compounding and get them on that retirement savings path."**
> *- Recordkeeper*

To facilitate this progression from short-term to long-term savings, one recordkeeper indicated that an emergency fund should be treated as "a very specific thing," and that once the short-term goal is reached, savers should "move to the next one," such as contributing to retirement.

An emergency savings solution can also help onboard nonparticipants onto the platform to initially build short-term savings and ultimately start contributing to retirement savings in a pre-tax account.

Beyond retirement readiness, meeting plan sponsor demand and remaining competitive as more recordkeepers offer emergency savings products were also listed as motivations for offering or exploring emergency savings solutions.

> **"Plan sponsor appetite for a solution is important."**
> *- Recordkeeper*

A third of recordkeepers interviewed mentioned plan sponsor interest as factoring into their decision to offer an emergency savings solution. Over half mentioned wanting to keep pace with their competitors in offering emergency savings solutions. One recordkeeper described the process as a "positive feedback loop;" when plan sponsors and recordkeepers increasingly demand or provide emergency savings solutions, other recordkeepers are more likely to offer such solutions.

Reduce Employee Financial Stress

Plan sponsors are considering emergency savings solutions to reduce employee financial stress and increase retirement readiness. The majority of plan sponsors stated that building emergency savings would help employees avoid credit card debt, hardship withdrawals, 401(k) loans, and employer loans. The goal of enabling financial resilience and preserving retirement savings aligns with Commonwealth's research: LMI plan participants with emergency savings were half as likely to take a 401(k) loan or hardship withdrawal during the pandemic.

> **"[Even pre-pandemic, we] observed high loan activity and increased hardship withdrawal activity. One top reason for the hardship withdrawals is to prevent foreclosure or eviction. There seems to be a significant lack of emergency savings for the employees, which is concerning."**
> *- Plan sponsor*

Ultimately, plan sponsors want to support employees on their financial journey. Given the widely recognized need to support employees in building emergency savings, the question is not "if," but "how" and "when" recordkeepers will offer emergency savings solutions.

> **"We feel so strongly that emergency savings is the right thing to do, since it would help people."**
> *- Plan sponsor*

A Common Definition of Emergency Savings

In order for recordkeepers to determine the "how" and "when" of offering emergency savings, stakeholders must agree on the "what"—a common definition of emergency savings. Our interviews with the largest recordkeepers revealed the lack of shared definition of emergency savings. Interpretations of emergency savings amounts ranged from $1,000 to enough to cover three to six months' expenses. Of the recordkeepers who defined emergency savings as three to six months of expenses, just under half recognized the importance of encouraging employees to start by building small-dollar savings, because starting with a goal to save three to six months of expenses can be too daunting for many employees.

Among the varied definitions, one recordkeeper had a clear, research-driven definition that defined two categories for emergency savings: funds to cover expense shocks and funds to cover income shocks.

FUNDS TO COVER EXPENSE SHOCKS

- Expense shocks require up to $2,000 or half a month's worth of living expenses (whichever is greater) to handle unexpected one-time expenses, like car repairs or a medical bill. This includes of regular, small-dollar expense shocks faced by LMI households from paycheck to paycheck.
- In developing their savings product, one recordkeeper focused exclusively on expense shocks (though did not use that label) and chose to keep the notion of a job loss fund entirely separate. They arrived at this definition by focusing on LMI employees: "If you can get a family to have $1,000, that starts to prevent the need for payday loans, and starts to make a lot of things less stressful."

FUNDS TO COVER INCOME SHOCKS

- To cover larger income shocks due to job loss or other major life events, savers should build up three to six months' worth of living expenses.
- The determination to save closer to three months' expenses vs. six months' expenses depends on an individual's employment stability and likelihood of readily finding other employment.

This definition of emergency savings and ensuing recommended approach of saving first for frequent expense shocks to build short-term financial stability and then for larger income shocks aligns with other industry research. With this framing, plan participants who cannot afford to save for many months of expenses can focus on short-term savings, which they can tap and rebuild without worrying about dipping into a fund that is supposed to be left untouched, such as retirement savings.

As recordkeepers communicate their emergency savings solutions to plan sponsors and plan participants, aligning on and promulgating one common definition (such as funds to cover expense and income shocks) would enable shared understanding so that the discussion can jump to product structure and features rather than staying mired in a debate on the right dollar amounts to save.

Return vs. Liquidity

Given the variation in understanding of the need for and use of emergency savings, it naturally ensues that recordkeepers expressed differing ideas on essential product requirements for emergency savings products, namely the optimal rate of return and level of liquidity.

Recordkeepers shared differing views on the ideal rate of return: one emphasized concerns about a "cash drag" if employees kept three to six months of expenses in cash, and thus recommended investing the funds. In contrast, another recordkeeper placed little priority on rate of return: "Given where we are with interest rates, [rate of return is] less of a consideration. [It's] more about the convenience."

Three recordkeepers prioritized a product that is liquid but not too liquid. As one said, they are "not into giving out debit cards," but if a participant faces an emergency expense, they want to enable them to "get at [their funds] relatively quickly," defined as within two days by two recordkeepers. While two recordkeepers expressed concern that if funds were too accessible they would be used for daily expenses, most agreed that those concerns were outweighed by the ability to access funds immediately during an emergency. Another recordkeeper was leaning toward a bank account solution that could have a connected debit card for immediate liquidity, and another recordkeeper repeatedly cited "accessibility" as a key requirement.

The two-tiered definition of emergency savings that one recordkeeper shared resolves the liquidity vs. return debate.

Funds to cover expense shocks should be in cash or cash equivalents and highly liquid, ready to pay for a car repair or an unforeseen dentist visit. Commonwealth's research indicates that when expenses match or exceed income, even a seemingly small unforeseen expense, such as a gift or a school uniform, can constitute an emergency expense.

Beyond the cash needed for expense shocks (under $2,000), the funds to cover income shocks (approximately three to six months' expenses) "need to be liquid, or accessible to you at a minimal cost, but not necessarily free from market risks," according to one recordkeeper's research.

For the funds to cover larger income shocks, rate of return (with some accompanying risk) should be prioritized over instant access to allow for asset growth. The recordkeeper's research noted that ideally these guidelines would be personalized, because a variety of factors increase or decrease each person's likelihood of both expense and income shocks.

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The Pressing Need to Support LMI Employees

Due to rising cost of living, stagnant real wages, and increased income volatility, many American workers are struggling to make ends meet. And yet, low- and moderate-income (LMI) Americans are saving. The U.S. Financial Diaries project found that for the average household in the study, total flows into savings accounts were four times larger than year-end balances.

LMI households are building small-dollar savings and using that savings to reduce income volatility and cover unexpected expenses. While a few hundred dollars in savings may not seem significant, research shows it can increase housing security, enable people to keep their utilities on, and avoid high-cost debt.

While two interviewees shared the viewpoint that if funds are too easy to access, savers will spend it on day-to-day purchases such as lunch or beer, research shows that the majority of savers seriously weigh the consequences of tapping their savings and that employees value control, privacy, and, immediate access to funds for workplace-offered emergency savings.

With as many as 78% of Americans living paycheck to paycheck, the majority of employees will need quick access to cash for an unexpected emergency at some point.

Plan sponsors and recordkeepers have a role to play in increasing employee financial security, especially for LMI employees. The vast majority—65% of Americans overall and 81% of Black Americans—believe that employers have a role to play in offering solutions to increase financial security. All three of the plan sponsors we interviewed who had a significant portion of LMI employees recognized that their lower-income employees have different financial needs than their higher-income employees.

One plan sponsor emphasized the need to meet LMI employees where they are and to encourage them to build emergency savings to increase financial security before focusing on longer-term financial goals. Another plan sponsor indicated that their company would consider a segmented approach to matching emergency savings—offering the benefit only to their lowest-income employees who need it most.

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The *How:* How Recordkeepers are Implementing Emergency Savings Products

The Emergency Savings Landscape: Who is Leading the Charge?

All but one of the recordkeepers we interviewed either offer or are planning to offer an in-plan or out-of-plan emergency savings product. Two offer an in-plan solution: Prudential, who offers it to all of their clients, and Voya, who offers it to a subset of UPS employees. Two offer out-of-plan solutions through one of their own financial accounts, including Fidelity's Goal Booster, which includes the option to save for a rainy day in a cash management account and to track progress toward savings goals. Several others are actively considering or taking steps to offer out-of-plan emergency savings solutions; some of these are also considering piloting an in-plan solution.

While the seven plan sponsors we interviewed recognized the importance of emergency savings, they had varying opinions on what actions they should take to encourage employees to save for emergencies.

The majority of plan sponsors we interviewed have messaged or plan to message their employees about saving for emergencies. Such messages include information on the importance of emergency savings, the amount to save, and setting up automated savings. One plan sponsor specifically encouraged employees to set up split deposit for emergency savings that would allow them to automatically save a portion of each paycheck.

All plan sponsors have considered implementing an emergency savings benefit in the near-term, with just over half of the plan sponsors planning to do so through either their recordkeeper or credit union. A product that meets the main requirements detailed below (see page 17) could be the key to greater adoption among plan sponsors.

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If You Build It, Will They Come?

As both recordkeepers and plan sponsors know from experience, offering quality financial products and resources is in some ways the easy part—ensuring that employees use and benefit from those products and services is the vexing challenge. Commonwealth has decades of experience in advising on making saving fun and easy through prize-linked savings (PLS), gamification, and automation. PLS products make saving fun and exciting by offering savers the chance to win prizes based on saving activity. The more the person saves, the more chances they have to win. Prize savings on the Walmart MoneyCard has driven billions of dollars into the card's savings pocket

Another savings strategy to make savings fun involves adding gamified elements such as badges or levels. Commonwealth developed SavingsQuest, a gamified microsavings tool, in 2015. Since then, several financial institutions have adopted these ideas. To make savings easy, nothing beats automation! Thanks to Commonwealth's CAST Template, plan sponsors can now pilot auto-enrolling employees to save for emergencies. Auto-enrollment with opt-out has doubled participation in defined contribution plans from 44% to 86% according to one study; imagine what it could do to increase employees' emergency savings! Contact Commonwealth to learn more about this exciting autosave opportunity.

Product Structure: In-Plan vs. Out-of-Plan

In offering an emergency savings product through a retirement platform, recordkeepers must choose whether to offer the product within the 401(k) plan using the after-tax or deemed Roth account, outside of the 401(k) plan, or offer both options.

When offering outside of the 401(k) plan, recordkeepers may choose to partner with a financial institution or fintech, leverage an existing account if the recordkeeper also offers banking or investing products (e.g., cash management account), acquire a fintech, or build a new solution in-house. Based on our interviews with nine of the largest recordkeepers, the majority are leaning toward offering out-of-plan solutions, though several said they would offer both in-plan and out-of-plan solutions to meet plan participant and plan sponsor demand.

IN-PLAN CONSIDERATIONS

When considering the in-plan option, a few recordkeepers highlighted the pros of pre-existing payroll integration, easy implementation for the employer, and the potential to increase plan participation among LMI employees.

One recordkeeper described the in-plan option as low-friction both for the plan participant (no need to go through the steps to set up a new account; automated paycheck deductions) and for the employer (offered through a pre-existing vendor that is already integrated with payroll). As another recordkeeper stated, the in-plan, after-tax account checks a lot of boxes: "already in the plan, already payroll deduction, can see it in their consolidated account."

The in-plan option could have the additional benefit of creating an on-ramp for retirement savings. One recordkeeper initially decided to explore the in-plan option to increase plan participation among LMI employees:

> **"It's there for that short-term emergency but really the goal is to get participants in there, start saving, realize the benefit of compounding, and get them on that retirement savings path."**
> *- Recordkeeper*

One respondent acknowledged that a mindset shift is needed:

> **"If we want [in-plan emergency savings] to take off, the industry has to reorient participants about what their plan can do for them."**
> *- Recordkeeper*

Challenges of in-plan solutions include confusing messaging; compliance and tax implications; and sub-optimal user experiences. Several recordkeepers expressed concerns that promoting the use of an account in the retirement plan for emergency savings would send a mixed signal to plan participants.

> **"How would they communicate that the plan they have said should not be touched could now be tapped for an emergency?" one recordkeeper asked. (An advocate for the in-plan option also acknowledged, "it's a big behavioral shift. It's a different way to think about your 401(k) plan.")**
> *- Recordkeeper*

Several other recordkeepers expressed concerns with a difficult withdrawal process that includes taxes and penalties: earnings in the after-tax account are taxed and charged a 10% penalty (if the participant is younger than 59.5) upon withdrawal. Coupled with what a few described as sub-optimal user experience and less accessibility, recordkeepers overall were bearish on offering emergency savings in the retirement plan.

> **"We don't have to solve all this stuff in a 401(k). Half the country doesn't have a 401(k). I see folks building these matching programs inside a plan and they're willing to pay the 10% penalty, it doesn't have to be solved in ERISA… Tunnel vision in some ways. Building for us and not for the user."**
> *- Recordkeeper*

Although it could be possible to leverage the in-plan option's existing payroll integration while addressing the concerns regarding user experience—for example, by completely reconfiguring the user interface to make saving for emergencies feel markedly different from saving for retirement—none of our respondents plan to do so at this time.

OUT-OF-PLAN CONSIDERATIONS

The benefits of out-of-plan option include the ability to launch faster, to incorporate engaging product features, and to allow for portability between employers.

As one recordkeeper shared, "if there is an immediate leaning to get a product to the market, they would do it out of plan." While this may seem counterintuitive because in-plan accounts already exist and hook into payroll, consider that only 15%-20% of plans offer in-plan after-tax accounts. A large-scale rollout of an in-plan solution would involve convincing plan sponsors to modify their 401(k) plans; additionally, changing user experiences with legacy record keeping systems can be time-intensive (especially if there are multiple systems due to acquisitions).

Another recordkeeper said out-of-plan would be faster to launch, specifically noting that the ability to pilot with a third party would require relatively little time and resources and enable the record-keeper to “learn a whole lot, and push the decision about acquire vs. build down the road.”

Two recordkeepers highlighted the out-of-plan option’s greater flexibility with product features and user design: they can add “perks and features” and “provide a system for people to access products to help them be successful.” Finally, one recordkeeper shared that out-of-plan emergency savings products are portable between employers: “I don’t want my emergency savings caught up in a roll-over if I have to leave my employer.”

Drawbacks of the out-of-plan option include the potential for fees assessed to the employee or employer and increased regulation if offering a retail banking product. One recordkeeper had explored partnering with other providers to offer an out-of-plan emergency savings product, but did not proceed because of third-party fees for users.

Additionally, for recordkeepers that do not have retail banking or investing lines of business, introducing a retail banking product with a third-party provider introduces new regulatory burdens, specifically related to Know Your Customer (KYC), which adds friction to the sign-up process by requiring specific user information.

Unless the solution is highly integrated and the employer can pass employee information to the banking partner, the employee will have to go through all of the standard steps to open a new account with a financial institution, which could cause drop off in engagement.

Plans to Offer Both In-Plan and Out-of-Plan

Ultimately, several recordkeepers are considering both out-of-plan and in-plan options to satisfy the preferences of different plan participant populations and different plan sponsors.

Roughly half of the plan sponsors we spoke with were in favor of the in-plan option for emergency savings, citing higher rates of return for “idle cash,” and relatively quick, low-cost implementation to leverage a pre-existing account that is hooked into payroll and allows employer matches. One plan sponsor was especially focused on the rates of return, having run models indicating that even with the tax and penalty on earnings, employees would be better off with the in-plan option than with a savings account at a bank.

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The several plan sponsors who opposed offering an in-plan emergency savings option cited the same concerns as recordkeepers: confusing messaging; taxes and penalties; and potentially diffucult implementation. One plan sponsor indicated that mixed messaging is an obstacle: "The communications are difficult because they want employees to view the 401(k) plan as long-term savings and not a source of cash if they need it."

Another very large plan sponsor with more than 300,000 employees has approximately 50 401(k) plans and is hesitant to add complexity to their retirement offerings. When considering out-of-plan options, the seven plan sponsors we interviewed were open to the idea, but needed these solutions to meet specific requirements (see page 17 for more details).

Recordkeepers' Go-to-Market Strategy: Build or Partner?

In determining which emergency savings product to offer as part of their go-to-market strategy, recordkeepers evaluated their options based on what financial products their company currently offers and their past experience with third-party partnerships.

BUILD

Recordkeepers that offer accounts well-suited to emergency savings (e.g., savings accounts, cash management accounts) were interested in leveraging them as an emergency savings solution for plan sponsors, but were hesitant to cross-sell their own products.

Offering their own accounts often means they can do so without the plan sponsor having to establish a relationship with a new third party. However, one recordkeeper mentioned that plan sponsors had concerns about allowing recordkeepers to cross-sell to their employees (two of the seven plan sponsors we interviewed raised this concern).

PARTNER

Without the option to adapt their own financial products for emergency savings, most recordkeepers wanted to implement external products as a lower-cost, more flexible solution. Many recordkeepers' decision-making process around implementation of emergency savings is influenced by past experience with third-party fintech partners. Some expressed being wary of early-stage, small companies who could be "snatched up by competitors," are at risk of going under, or have underdeveloped security infrastructure.

Recordkeepers are also looking for strong data security, demonstrated success with both B2B2C through employers and direct to consumer, and company cultural alignment. Ideally, a solution would also allow for simple implementation and minimal changes to existing recordkeeping systems or user experience. Finally, recordkeepers also noted resource requirements, including cost to the recordkeeper, would be factored into their decision.

A Focus on Plan Sponsor Adoption

Whether leveraging an existing product, partnering with a third party, or building a new product in-house, recordkeepers must focus on plan sponsor adoption to be successful. In the seven interviews we conducted with plan sponsors, they shared the following key considerations for implementing an emergency savings solution:

- **Acting as a fiduciary for their employees:** Three plan sponsors expressed concern about potential conflict of interest for promoting a specific financial product and allowing recordkeepers to cross-sell products. Two plan sponsors wanted to ensure an optimal rate of return and several wanted to minimize fees charged to employees.
- **Driving employee engagement and utilization:** Engagement strategies might involve low-friction sign up, gamification, application of behavioral economics principles, and an easy-to-use digital user experience to drive engagement.
- **Evaluating cost:** Plan sponsors were somewhat split on cost. While one said that cost was "less of a consideration," three others stated that because their benefits budget was fixed, cost would need to be considered in evaluating solutions.
- **Limiting total number of benefits vendors:** Four plan sponsors expressed a preference to work with a pre-existing vendor, which would avoid the expense and effort of onboarding a new vendor and also to simplify the employee experience with fewer platforms.

Survey respondents cite unexpected expenses as a main barrier in saving for retirement. Saving first for emergencies will put employees on the right trajectory to save for retirement.

The *When:* Expediting the Widespread Adoption of Emergency Savings

Insights and Implications

While leading recordkeepers are already offering or planning to offer emergency savings products, actions within the retirement industry, by technology providers, and by government regulatory bodies, could expedite this trend. Within the retirement industry, recordkeepers need to embrace a common definition of the two types of emergency savings needs for workers—small-dollar funds that are highly liquid to cover expense shocks, and accumulated funds to cover larger income shocks—and how they differ.

Industry-wide adoption of this definition for two types of emergency savings will ensure that industry actors—from recordkeepers and third-party providers to plan sponsors and advisors—are starting with the same foundational knowledge of the "job(s) to be done" for emergency savings and meeting the financial needs of employees across income bands.

Recordkeepers and plan sponsors reported that they would act more urgently on emergency savings initiatives if stronger evidence existed to demonstrate that offering emergency savings leads to greater plan participation. This body of evidence is starting to build: as one recordkeeper that offers in-plan emergency savings shared, they have "seen a lot of people who weren't contributing start contributing. And some people will add an extra 1% on and put it in emergency savings. It's not an 'or' strategy, it's an 'and' strategy."

TECHNOLOGICAL INNOVATION CAN HELP FACILITATE ADOPTION

Technological innovation can help facilitate back-end money movement, enable a more seamless front-end experience, and expedite the adoption of workplace emergency savings products. To allow automated paycheck deductions to an out-of-plan account (and thus allow plan sponsors to avoid onboarding another vendor), recordkeepers may need to explore partnerships with payment processors or white-label banks.

One recordkeeper proposed having a middleware company facilitate the flow of payments and data between various financial institutions and the plan participant through the recordkeepers' payroll integration. Although this may be technically challenging and could add regulatory complexities, this type of innovative problem solving and focus on meeting the needs of plan participants is necessary to advance the field.

GREATER REGULATORY CLARITY WOULD ELIMINATE CONCERNS

Although regulations allow recordkeepers and plan sponsors to offer emergency savings both in-plan and out-of-plan, a few recordkeepers indicated that greater regulatory clarity would mitigate concerns and expedite adoption for risk-averse firms. Commonwealth will explore regulatory questions related to workplace emergency savings in greater detail in a subsequent policy brief.

Conclusion

An Urgent Need for Quality Emergency Savings Products for LMI Employees

As insights from our interviews demonstrate, it is no longer a matter of “if,” but rather “how” and “when” recordkeepers will offer emergency savings products. We recommend that the “when” be as soon as possible, because the emergency savings crisis has only been exacerbated by COVID-19.

CENTER THE NEEDS OF LMI WORKERS

We recommend that the “how” be centering low- and moderate-income (LMI) employees most in need of an affordable, accessible solution. To best serve LMI employees, recordkeepers and plan sponsors must meet them where they are by supporting employees in fulfilling their immediate financial needs to enable them to progress to building retirement savings. Emergency savings serve as a buffer to even out plan participants’ financial volatility, protecting them from costly debt, and thereby setting them up to have more income to contribute to retirement savings.

STRENGTHEN EMPLOYEE ENGAGEMENT AND BENEFITS PROGRAMS BY IMPROVING FINANCIAL SECURITY

In addressing the issue of emergency savings, recordkeepers and plan sponsors not only improve the financial security of U.S. workers through initiatives, but can increase employee engagement, strengthen existing benefits programs, increase employee savings rates, and reduce early retirement withdrawals.

With many recordkeepers either currently offering or on the verge of offering emergency savings solutions, the industry will have more information about the impact and design of emergency savings products. By running pilots and user testing, recordkeepers and plan sponsors can experiment with the solutions and solution features that work best for their needs and those of their plan participants and employees.

The pandemic and current economic crisis shine a spotlight on the longstanding inequities in our financial system, and the essential role that institutions like employers and recordkeepers play in supporting Americans’ financial security. There is no better or more urgent time for recordkeepers and plan sponsors to take the steps necessary to provide emergency savings tools.

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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