Designing Effective Emergency Savings

Commonwealth and Voya's Findings from the Field

Commonwealth, in collaboration with Voya Financial, recognizes that a lack of adequate emergency funds for employees can often put retirement security at risk. The reality of the precarious state of retirement savings in the U.S. is unsettling, particularly as the Boston College Center for Retirement Research estimates that half of households—including three-quarters of low-income households—are at risk of not being able to maintain their standard of living in retirement. As a result, Commonwealth and Voya are working together to test and research creative solutions to help address this challenge and ultimately advance what is effective for encouraging emergency savings while preserving retirement savings. Through our research and collaboration on emergency savings, we have learned three important lessons:

1) Emergency savings should be considered its own "bucket" of saving

Emergency savings accounts should be a separate "bucket" from retirement assets, whether in-plan (such as an after-tax account) or out-of-plan (such as a stand-alone bank, credit union, or cash management account). When well-designed, these savings can effectively preserve an individual's retirement savings and help them to save more for emergencies. With this principle in mind, Voya recently launched a solution with Millennium Trust that provides out-of-plan emergency savings support alongside a Voya retirement plan or other workplace savings accounts.

A properly designed and separate emergency savings account can help protect retirement savings when emergencies arise. Research shows emergency savings in general can be an important buffer against early withdrawals from retirement savings. Throughout the pandemic, households with at least $1,000 in liquid emergency savings were half as likely to withdraw from their workplace retirement savings accounts. According to a recent Commonwealth and SaverLife survey, those with access to retirement plans said a stand-alone emergency savings account would make them likely to contribute more to their retirement account.

Additionally, separate accounts earmarked for emergencies can be particularly valuable. According to Commonwealth research, those individuals with at least one account specifically designated for emergency savings are 8% more likely to have a higher amount of liquid savings (over $500), compared to those who might save for emergencies, but do not have a specifically earmarked emergency savings account.

Prior research also illustrates the linkage between inadequate emergency funds and higher likelihood of taking a hardship or loan from one's retirement plan. Specifically, research from Voya has found that participants with inadequate emergency funds are 13 times more likely to take a hardship withdrawal than those with adequate savings. In today's society, families can face multiple economic shocks in a single year with emergencies often costing over $1,000, and some costing several thousand dollars. Data from Voya also shows that just over 20% of participants who take a hardship end up requesting at least one additional withdrawal within 12 months.

In working together with UPS, Voya and Commonwealth collaborated to help encourage UPS employees save for emergencies in their in-plan, after-tax retirement savings account, which shows withdrawals average about $1,100. What's more, according to industry data, the average hardship withdrawal is close to $3,000, suggesting that households without an adequate emergency savings fund are tapping their retirement.

Developing solutions that allow employees to both save for emergencies in a separate account and accumulate balances that reflect the reality of expense shocks that households face can improve both short- and long-term financial security.

2) Emergency savings does not crowd out retirement savings

A related key finding from Commonwealth's work is that the crowd-out effect sometimes attributed to separate emergency savings (positing that short-term savings will come at the expense of retirement savings) does not occur, even for low- to moderate-income (LMI) employees. In fact, emergency savings may help retirement plan participants to more easily manage short- and long-term savings.

In the work with UPS, Voya and Commonwealth also researched the concept of making emergency savings an "active choice," where employees must choose whether to contribute to a separate emergency savings bucket. Early data from this research has found that emergency savings did not "crowd out" retirement saving.

When it comes to managing multiple, competing, and confusing ways to access funds intended for retirement, such as loans, hardship withdrawals, and early distributions, a separate account can often be easier for employees. According to additional Voya research, nearly half of Americans who took out a loan or withdrawal as a result of the COVID-19 pandemic took more than needed, demonstrating the potential unintended consequences of topping core retirement funds. A separate emergency savings account offered through an employer, alongside a retirement account, is unlikely to negatively impact long-term savings and could also be easier for employees to manage from a mental accounting perspective.

3) Positive messaging matters to drive uptake of emergency savings

Offering a separate emergency savings option is often not enough to lead to engagement and use. To drive participation and greater long-term savings results, research shows that programs must have design features as well. Findings from Voya show that people who saw positive messaging, compared to neutral or negative messaging, were more likely to take a critical step towards enrolling in emergency savings (including LMI households). These findings are also supported by Commonwealth's research on non-financial factors relevant to reaching financial security: a journey mindset, aspiration- and value-centered motivations, social networks, and inclusive messaging. Plans should consider these insights when designing emergency savings options.

Conclusion

By applying these principles, recordkeepers and plan sponsors can help support their employees in building emergency savings while at the same time preserving and growing long-term savings. Finding opportunities that will meet the needs of working Americans, and that reflects the realities of managing unexpected expenses, especially for LMI households, can ultimately lead to better retirement outcomes.

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Commonwealth
Commonwealth is a national nonprofit building financial security and opportunity for financially vulnerable people through innovation and partnerships. Black, Latinx, and female-led households disproportionately experience financial insecurity due in large part to longstanding, systemic racism and gender discrimination. Addressing these issues is critical to Commonwealth's work of making wealth possible for all. For nearly two decades, Commonwealth has designed effective innovations, products, and policies enabling over 1.5 million people to accumulate more than $6 billion in savings. Commonwealth understands that broad changes require market players to act. That's why we collaborate with consumers, the financial services industry, 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.

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Blackrock
BlackRock announced a $50 million 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. Learn more at www.savingsproject.org.

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