Helping Families Save to Withstand Emergencies

Many American Families Don’t Have Emergency Savings
According to Prosperity Now’s 2019 Scorecard, two out of every five households in the country (40%) lack savings to withstand a long-term financial shock. Considered to be liquid asset poor, these families do not have enough short-term savings to cover three months of basic living expenses at the federal poverty line in the event of a sudden job loss, medical emergency or other crisis. When broken out by race, households of color (57%) are nearly twice as likely as White households (32%) to be experiencing liquid asset poverty. Liquid asset poverty is especially prevalent among Black and Hispanic households, 63% of which are liquid asset poor.

Without savings, people have few options in an emergency. These individuals are often forced to borrow money in a financial emergency, either from friends or family members, banks or other sources of mainstream credit, or predatory payday lenders. (Payday lenders, which are much more expensive than bank loans, extract more than $9 billion a year in fees from vulnerable communities.) Others are simply unable to pay for an emergency expense at all.

A lack of savings not only leaves families feeling financially insecure, it can also leave them vulnerable in times of economic uncertainty. Nearly half (49%) of American families say they do not feel financially secure, a data point that rises as high as 75% in low-income and low-wealth households. Playing a large role in these feelings is a lack of savings, which 33% of American families attribute as their source of financial insecurity. At the same time, another major driver of concern is income volatility, which increases insecurity for many low-income families who cannot reliably predict income from one month to the next. Changes in working hours and the need to juggle multiple jobs mean earnings could be significantly lower in the following month. The lowest-income families face the greatest financial instability, with an average of 26% of annual income being unpredictable. This means that one month’s savings could have to supplement bills in the next month. Despite saving money each month, families may have little to no savings accumulated at the end of the year. Without emergency savings, families are not able to weather financial shocks without going into debt, creating financial instability in the short term.

Short-term savings can help build a pathway to long-term financial wellbeing. When families have no or limited short-term savings, setting aside money for larger goals—like buying a house or sending children to college—is perceived as too much of a risk. Having emergency savings not only helps people achieve financial stability, it can also make them feel secure about putting money in restricted retirement accounts for the long term and makes them less likely to withdraw retirement funds early—
incurred fees and reducing an important nest egg. Savings also enable economic mobility, savers are more likely to move into a higher income quartile. The benefits of building savings can even be passed down to future generations, as children in low-income households whose parents have savings tend to earn more than their parents later in life.

Key moments in the life of working families, such as tax time and the workplace, should be leveraged to encourage savings. For many working families, tax refunds are a crucial source of income each year, and they can be used to build savings. Employers can also play a role in creating greater financial stability for workers by providing access to workplace savings plans—along with features like payroll deduction—that make it easier for workers to save.

**Tax Time Is an Opportunity to Build Savings**

Tax refunds are essential to working families’ financial stability. For low- and moderate-income families, tax refunds often account for as much as one-fifth of annual income, the equivalent of three months’ wages. Income from a tax refund can be used for important purchases and to shore up financial obligations. Surveys have found that working families most often use their tax refunds to pay off debt, pay bills, and for normal consumption that might be deferred at other times of the year. Families also use these refunds to buy big-ticket items, like household furniture or putting a down payment on a car for driving to work.

Tax time is particularly important for families that receive the Earned Income Tax Credit (EITC). In 2018, 25 million workers claimed an average $2,488 in EITC benefits, delivered as lump-sum payments through families’ tax refunds. Combined with the Child Tax Credit (CTC), the EITC lifted 8.3 million people out of poverty in 2017.

Tax credits for working families, such as the EITC, have been tied to significant positive outcomes for workers and their families. For example, in addition to financial stability, recipients of the EITC experience further benefits from early childhood through retirement. These include improved infant health, higher test scores in school, greater college enrollment, increased earnings as adults and higher Social Security benefits in retirement.

**How the Refund to Rainy Day Savings Act Can Help a Family Build Emergency Savings at Tax-Time**

*Consider a family who is eligible for a $2500 tax refund...*

<table>
<thead>
<tr>
<th>At Tax Time</th>
<th>...Six Months Later</th>
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<tbody>
<tr>
<td>The family will receive $2000</td>
<td>They will receive a Rainy Day payment of more than $750 (80% of the standard tax refund)</td>
</tr>
<tr>
<td>TAX REFUND $2000</td>
<td>$500 deferred tax refund + $250 savings match + accrued interest</td>
</tr>
</tbody>
</table>

| The family will receive $2500 | They may not have money for an EMERGENCY |
| TAX REFUND $2500 | |

*SOURCE* | The Rainy Day EITC, CFED, 2015
The EITC can be further leveraged as a savings tool. Because tax refunds and the EITC are so important to working families’ budgets, they also represent an important opportunity for saving. Tax season may be the only time of year when an EITC-recipient family has any financial cushion, so it may also be the only time they have the leeway to save. Pilot programs have shown that presenting tax filers the option to defer some of their refund or place it in a savings account leads to more saving, especially when leveraging tools like automatic enrollment and incentives like matching funds. The SaveUSA pilot, for example, gave low-income tax filers the option to deposit at least $200 of their tax refund in a new savings account and receive a 50% savings match if they saved the money for a year. This led to a 7% rise in the number of people with savings and an average savings increase of $512.16

Existing tax policy primarily incentivizes wealthy households—rather than low- and moderate-income households—to build savings. For example, the tax exemption for 401(k) plans can go up to $19,000, so higher-income individuals with more money to set aside for retirement are likelier to benefit. The tax code does encourage retirement saving among low- and moderate-income families via the Saver’s Credit, a tax credit that rewards contributions to retirement accounts. But since the credit is nonrefundable, it cannot be used to reduce the total taxes one household owes below zero. What’s more, the Saver’s Credit doesn’t reward savings outside of retirement funds, so it does nothing to incentivize preparation for a financial emergency.

Employers Can Play a Role in Helping Families Save
Workplace retirement savings programs can offer a foundation for emergency savings. There is already an infrastructure to encourage savings in many American workplaces. Retirement savings options are available to 67% of workers.7 Although many workers still lack access to workplace-based retirement plans and others do not participate, citing unaffordability, the successes in retirement savings offer lessons for other kinds of saving.

Today, five states (California, Connecticut, Illinois, Maryland and Oregon) are addressing the access problem with “AutoIRA” policies that enroll workers who do not have access to retirement savings in state-sponsored Individual Retirement Accounts (IRAs).8 Expanding upon the work done in states, Sen. Sheldon Whitehouse (D-RI) and Rep. Richard Neal (D-MA-1) proposed the Automatic IRA Act of 2017, which would require employers without retirement plans to make an IRA available to their workers nationwide.9

Behavioral insights can be leveraged to encourage different kinds of savings. Research has shown that automatically enrolling workers in retirement savings programs leads to more participation.10 When employers automatically include employees in their retirement plan—with the option to opt out—more people save money, compared to workplaces that require workers to opt in to a plan.

The creation of separate “buckets” for retirement and rainy day savings encourages both short- and long-term savings. Separate after-tax short-term savings accounts make it easier for workers to save by giving them access to a savings vehicle. These accounts also emphasize the importance of saving for emergencies and can impact workers’ “mental accounting,” ensuring saving is a priority in monthly budgeting.

Families with unpredictable monthly income may be hesitant to save for long-term goals because of the need to spend savings towards stabilizing monthly budgets. Creating separate accounts makes it easier and more likely that low-income workers who prioritize stability over income will participate in savings at all.
Workplace-based rainy day savings options could be implemented under current law. Employers can encourage saving for emergencies by offering emergency savings accounts as a benefit, similar to retirement savings. Under current law, with little administrative effort, workplaces could set up after-tax short-term savings accounts as part of a 401(k) plan using several different models, which would protect workers’ investment and could allow employees to automatically deposit savings from their paychecks. This can also be done completely separately from a retirement plan, such as a 401(k).

Congress Can Help Families Save
By taking the following actions, Congress can help families build short-term savings to protect against unexpected expenses:

- **Expand access to emergency and retirement savings through the workplace.** Introduced by Sens. Chris Coons (D-DE) and Amy Klobuchar (D-MN), as well as Reps. Scott Peters (D-CA-52), Lucy McRath (D-CA-6) and Lisa Blunt Rochester (D-DE-AL), the Saving for the Future Act (S. 1053 and H.R. 2120) encourages both short- and long-term savings by mandating that employers provide workplace-based savings solutions to their employees. The bill calls on employers to contribute at least 50 cents per hour worked by their employees to a retirement savings plan, while also auto-enrolling workers into the program at a contribution off four percent of their own earnings. Employers who do not currently offer a plan can use the federally provided UP Accounts, which also include an emergency savings component by allowing workers to put the first $2,500 they accumulate into a UP-Savings account. In addition, the bill provides flexibility to smaller employers by offering them tax credits for their retirement contributions or allowing them to opt out, depending on the size of the business.

- **Leverage tax refunds to help working families handle financial emergencies.** The Refund to Rainy Day Savings Act (S. 1018 and H.R. 2112), introduced by Sens. Cory Booker (D-NJ), Tom Cotton (R-AR), Doug Jones (D-AL) and Todd Young (R-IN), as well as Reps. Bonnie Watson Coleman (D-NJ-12) and French Hill (R-AR-2), would help working families handle financial emergencies that occur throughout the year. In doing so, this legislation would allow tax filers to defer 20% of their tax refund, which would accumulate interest for six months before being deposited into the filer’s direct deposit account. The bill includes a pilot program to match deferred tax refunds for lower-income EITC filers, further encouraging the use of the tax credit as an emergency savings tool. Finally, the bill expands the flexibility of the innovative Assets for Independence (AFI) grant program, which encourages earnings, savings and self-sufficiency by offering matching funds to help low-income workers save and build assets.

- **Make it easier for employers to offer their workers emergency savings accounts.** The Strengthening Financial Security Through Short-Term Savings Plans Act (S. 1019), proposed by Sens. Booker, Cotton, Jones and Young as part of a savings package, would encourage employers to offer emergency savings as a benefit to their workers. This legislation would make it easier for employers to offer rainy day savings accounts to employees completely separate from any retirement accounts that may or may not be offered. These accounts would help workers build short-term savings through automatic opening and contributions, allowing families to prepare for the unexpected.

This brief was written by Michael Auslen and updated by Myrto Karaflos.

2 Liquid assets are those that are held in cash or can be liquidated quickly: bank accounts and other interest-earning assets, equity in stocks, mutual funds and retirement accounts (IRAs, 401(k)s and KEOGH accounts). Liquid assets exclude equity in businesses, vehicles, homes and other real estate. The threshold used to determine the liquid asset poverty rate varies by family size. A family of four with liquid assets less than $6,275 in 2018 is liquid asset poor. See “Liquid Asset Poverty,” Prosperity Now Scorecard, 2019, [http://scorecard.prosperitynow.org/data-by-issue#finance/outcome/liquid-asset-poverty-rate](http://scorecard.prosperitynow.org/data-by-issue#finance/outcome/liquid-asset-poverty-rate).
3 Ibid.
6 Ibid.
10 Ibid.