



## **INCREASING FINANCIAL SECURITY WITH WORKPLACE EMERGENCY SAVINGS**

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*With traditional workplace defined benefit pension plans now largely replaced by defined contribution (DC) savings plans, most Americans have become accustomed to the idea that they'll need to fund their own retirement. But many face day-to-day financial struggles that could jeopardize their chances for success. Nearly two-thirds of Americans—a stunning 63 percent—have not saved enough outside their retirement account to cover a \$500 emergency, meaning that even a minor car repair bill could be financially traumatic.<sup>1</sup> Unexpected events also take a toll on finances – 60 percent of families reported experiencing a financial shock within the past year.<sup>2</sup>*

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*Too often, this leads to high levels of stress and early raids on workers' retirement accounts. One study found DC plan participants under the age of 55 withdrawing a shocking 30 to 40 cents*

*from their retirement savings accounts, on average, for every \$1 they were contributing.<sup>3</sup>*

*This is no better news for employers than it is for employees. Research consistently shows that personal financial worries detract from employee engagement and productivity. And older workers who are not able to retire when they want can add to the cost and complexity of workforce management strategies. All this suggests that **reimagining DC plans – and leveraging their success – provides a great opportunity to help employees save for emergencies. Employers may wish to consider supplementing their DC plan with a new emergency savings feature.** This could help employees fortify their day-to-day financial health while simultaneously making it easier for them to reach their retirement goals.*

## The Need for an Emergency Savings Feature

A few decades ago, many American workers were able to focus on their day-to-day financial needs while letting someone else worry about funding their retirement—namely, the federal government, in the form of Social Security, and their employer, in the form of employer-sponsored pension plans. Today, it takes longer to qualify for full Social Security benefits, and traditional pension plans have largely disappeared, particularly in the private sector. In their place are DC plans that leave individuals with much of the responsibility for funding their own retirement.

Unfortunately, this dual challenge—to manage for today while also saving for tomorrow—is a struggle for many Americans. According to a recent study by Prudential, 57 percent of employees are very or somewhat stressed about their financial situation, with both immediate and long-term financial issues among their top concerns.<sup>4</sup>

While financial insecurity is more common among people with low incomes, it is hardly exclusive to that group. According to one recent study, the liquid net worth of the median American household headed by an individual between the ages of 41 and 51 is only \$813.<sup>5</sup> Financial insecurity can be triggered by a wide variety of life events across all income levels—leaving college with student loan debt, covering out-of-pocket costs associated with a medical event, buying a first car or home, sending children to college, or losing a job.

## Short-Term Savings Shortfalls Compromise Financial Wellness

Prudential recognizes that individuals may best be served when a holistic approach to financial wellness is taken. *Financial wellness is realized when individuals adopt behaviors that help them manage day-to-day finances, achieve important financial goals, and protect against key financial risks.* Americans with little to no short-term savings, and struggling with day-to-day finances, could be at a greater risk of compromising their overall financial wellness.

For this group, saving for retirement can become especially problematic. Finding it difficult to make ends meet on a day-to-day basis, they may choose not to participate in their workplace retirement plan, fearing they can't afford the hit to their take-home pay. Or, they may participate, but then withdraw money from their account prematurely to meet current living expenses. In fact, research by Prudential indicates that 31 percent of employees would consider taking a retirement plan loan or withdrawal to cover monthly expenses if their emergency funds ran out.<sup>6</sup>

Figure 1

## MANAGING DAY-TO-DAY FINANCES IMPACTS ABILITY TO ACHIEVE LONG-TERM FINANCIAL GOALS



Having little or no short-term savings also can make it hard for individuals to maintain the insurance coverages they need to protect against key financial risks, which could leave them vulnerable to the financial burden and stress that can accompany a disability, critical illness, or premature death in the family. Sadly, this may have the greatest adverse impact on those who need such protections most.

At the workplace, employees' financial stress may manifest itself in lower engagement and productivity. Nearly one in three employees (30 percent) report that issues with personal finances have been a distraction at work.<sup>13</sup> One analysis found that employees experiencing financial problems miss significantly more days of work – a full week – than those who do not experience financial problems. In addition, those who experience financial problems are more likely to experience a short-term disability.<sup>14</sup>

Against this backdrop, employees may need a holistic solution to their savings challenges—a dual-track approach that helps them build short-term reserves for unexpected expenses while still setting aside money for long-term savings goals. As long-standing providers of employee benefits, employers are viewed by employees as trusted partners who can help employees achieve financial wellness. Moreover, research indicates that individuals are more likely to use financial counseling services and tools aimed at budgeting, saving, and investing if those services and tools are offered by their employer.<sup>15</sup>

## The New Emergency Savings Workplace Solution

Making saving easier by funding contributions through payroll, employer-sponsored DC plans have become the primary vehicle for how Americans save for retirement. The retirement plan industry, including service providers, advisors and plan sponsors themselves, widely believes that the following features best align with employees' savings behaviors.

- Allowing employees to contribute to their plans via payroll deduction makes it easier for them to continue saving.
- Limiting the ability of plan participants to take loans from their retirement accounts makes it easier for them to benefit from the long-term advantages of compound growth.
- Pre-selecting investment opportunities reduces the time employees have to spend researching investment options on their own—and has helped deliver better investment outcomes.

- Automatic enrollment in retirement savings plans can overcome inertia and help individuals begin to save.
- Matching employee contributions with company contributions provides an incentive for employees to save, and boosts their account balances.
- Understanding the demographics and needs of the employee base can be critical in identifying ways to change financial behaviors.
- Analyzing employees' self-assessments, and their financial behaviors over time, can suggest ways to customize education and communication programs to inspire employees to take action.

Building on the success of DC plans, a “reimagined DC plan” could potentially help employees balance a broader array of needs by meeting the short-term needs that DC plans are not designed to address. Drawing on the learnings, and on ideas explored by a variety of academics and policymakers, *Prudential has developed a supplementary emergency savings feature for DC plans that can possibly help employees better manage their day-to-day finances.*<sup>16</sup> Intended as a complement to an array of financial wellness capabilities, its major provisions include:

- **An after-tax emergency savings feature tied to the employer-sponsored retirement savings account.** Employers can leverage their DC retirement plan infrastructure to offer this feature.
- **Funding via contributions through payroll.** Employees can decide how much they wish to contribute. Goal amounts may vary based on income. Unused balances become part of the employee's long-term retirement savings.
- **Optional employer matching contributions.** An employer match encourages employees to save. (Some employers may wish to consider using any tax savings realized from the Tax Cuts and Jobs Act of 2017 to fund matching contributions, and view it as an investment in talent management.)
- **Access to selection of investment choices.** Employees will have access to low-cost institutional investment options. Ideally, the investments offered will include liquid and low risk choices, such as stable value funds or money market funds.

Like the best DC retirement savings plans, this emergency savings feature is designed to help individuals overcome common behavioral obstacles to financial success, such as procrastination, underestimating risk, and impulse spending.

## Advantages of an Emergency Savings Feature for Employees

Emergency savings features offer a host of benefits for employees, including:

- **Ready access to funds.** Employees can withdraw funds from their emergency savings account at any time, although not quite as easily as withdrawing money from a bank savings account – to encourage building a balance without dipping into it. In addition to promoting use of the account, this may make employees more willing to contribute to their retirement savings plans, since they know they can access their emergency savings when needed. Upon withdrawal, after-tax contributions to emergency savings are free of taxes and penalties, but any earnings on the savings will be subject to applicable income taxes, plus a 10 percent penalty tax if withdrawn before age 59½.
- **Preservation of retirement savings.** Having an emergency savings feature could make it more likely that employees will leave their money in their retirement account—and so help them stay on track to retire when they wish. Access to an emergency savings fund also could prompt some employees to become more tolerant of risk in their retirement savings plans, thereby avoiding the temptation to invest so conservatively that it reduces their chances of achieving their retirement savings goals.
- **Peace of mind.** An emergency savings feature could reduce stress related to not having money for unexpected emergencies.
- **Ease and flexibility.** The emergency savings feature offers a convenient, systematic way to save at the workplace and track progress. The feature also offers employees the flexibility to select their contribution levels and their investments, and to withdraw funds as needed.

All of the benefits listed above can be magnified where employers choose to match employees' contributions. This can boost employees' savings in a meaningful way and improve their overall financial wellness.

## Advantages of an Emergency Savings Feature for Employers

Emergency savings features are not just good for employees, they can be good for employers, too. They could potentially:

- **Optimize employers' benefit spend by delivering benefits with little incremental cost or administrative resources.** Because the emergency savings feature is funded by employees and leverages existing infrastructure, employers can optimize their benefit offerings at little additional cost while helping to improve their employees' financial wellness.
- **Reduce leakage from retirement plans.** An emergency savings capability could help employees strengthen their day-to-day financial health which reduces the need to raid their retirement savings in the event of an emergency. In addition, any unused balances can be used for retirement.
- **Mitigate the cost of delayed retirements.** Because they reduce the need for employees to tap into their retirement savings prematurely, the emergency savings feature may make it easier for employees to retire when they wish. This may help employers by mitigating the added costs associated with delayed retirement, which have been estimated at an additional 1 percent to 1.5 percent of annual workforce costs for an entire workforce for every one-year increase in the average retirement age.<sup>17</sup> Delayed retirements also may result in other workforce issues, such as lower productivity, a lack of engagement, and excess turnover among younger workers due to lack of mobility.
- **Improve productivity and morale.** Improving employees' financial wellness may have a positive impact on their performance at work. Nearly eight in 10 financial executives (79 percent) believe their companies benefit from having a workforce that is financially secure.<sup>18</sup>
- **Improve talent management.** Bolstering employer-sponsored benefit offerings may strengthen the employee/employer relationship. Sixty-three percent of surveyed finance executives say employee satisfaction with benefits is important to their company's success.<sup>19</sup>

## Conclusion

Many American workers are struggling to balance the competing needs for short-term and long-term savings. Employers are well-positioned to help by supplementing their DC retirement savings plans with an emergency savings feature that leverages their existing retirement plan infrastructure. The results could be beneficial for employers and employees alike, creating a workforce that is both financially healthier and more productive.

## Key Takeaways

- **Emergency savings capabilities should complement, not replace, DC plan contributions.** Employers may consider an emergency savings feature part of a multipronged approach to helping employees achieve financial wellness, along with existing solutions such as educational programs, budgeting tools and calculators, and student loan repayment plans.
- **The presence of an emergency savings feature, funded via payroll deduction, may enhance the effectiveness of retirement savings plans** by reducing leakage from those plans and encouraging a long-term view of retirement plan assets.
- **Understanding the demographics and needs of the employee base is key to identifying ways to change financial behaviors.** Employers may benefit from implementing an employee self-assessment to learn where their employees need help.
- **Analyzing employees' self-assessments, and their financial behaviors over time, can suggest ways to customize education and communication programs to inspire employees to take action.**

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All investing involves various risks including the possible loss of principal. **It is possible to lose money by investing in securities.**

After-tax contributions withdrawn are generally tax-free. If you need to withdraw money from the after-tax account, it will include a pro rata share of the earnings from investments. Investment earnings are taxable as income upon distribution, and a 10% early withdrawal penalty on earnings may apply. You should consult competent tax advice when considering taking any withdrawals from retirement accounts. Keep in mind that Prudential does not give tax or legal advice.

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