Emergency Savings: Preparing Employees for the Unexpected

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Employee financial wellness has become an increasing concern for many employers, particularly in industries and fields that require advanced degrees, where organizational staff may be saddled with significant student loan debt. Debt from educational expenses, along with other types of debt (e.g., credit cards), can cause employees undue stress and harm their financial health. In an attempt to alleviate this problem, many employers now offer resources and tools to help employees better manage their finances.

One such tool that is helpful in developing financial wellness is the establishment of an emergency savings account. This emergency fund is intended to hold savings to be used for unforeseen expenses that only occur on rare occasions (such as a sudden illness or home repairs - birthdays and vacations are not emergencies!). To be most effective, the assets of an emergency fund should be held in a separate account, away from other savings. The fund should not be touched unless an urgent expense arises.

THE NEED FOR EMERGENCY SAVINGS

Emergency savings accounts are an essential component in preparing a personal budget that is often overlooked. The need for emergency savings is an important concept to convey to staff, because many people do not have the savings to cover unexpected expenses. In a recent survey, 60% of respondents indicated that they did not have the savings to meet a $1,000 expense. Additionally, 30% responded that they had incurred unexpected expenses in the past year[1].

In another recent survey, over 70% of respondents indicated that they would have significant financial difficulty if their paycheck were delayed for one week[2]. This illustrates how frequently individuals are living paycheck-to-paycheck and, thus, require a mechanism to protect their financial well-being. Emergencies can happen at any time. As such, it is important to prepare as best as possible.

Ideally, an emergency savings account holds between three and six months of income to provide a financial cushion for unanticipated needs. However, any amount of savings for emergencies helps. Even as little as $300 to $500 provides some security and assurance.

Without an emergency savings account, people often rely upon their credit cards to cover these types of expenses. This can be problematic when the balance on those credit card bills cannot be paid off in full at the end of the month, as interest payments will be required by the credit card companies. The interest rate on these payments can be exorbitant.

An emergency savings account can also help to reduce retirement plan leakage. Individuals experiencing emergencies may take money from their retirement savings

[1]Bankrate.com Financial Security Index survey – January 2019
[2]American Payroll Association, Getting Paid in America, September 2019

through a loan or a distribution, if permitted under plan rules, to help pay for unexpected costs. Participants who have saved for emergencies can avoid depleting their retirement assets due to urgent needs.

HOW RETIREMENT PLAN SPONSORS CAN HELP?

Retirement plan sponsors have been trying to develop ways to make establishing and maintaining an emergency savings account simpler for their employees. One option is to offer an emergency savings account through the retirement plan recordkeeper. As the need for emergency savings accounts has become more apparent over time, many retirement plan recordkeepers have explored offering these types of accounts. Several recordkeepers have implemented emergency savings accounts as “sidecar” accounts to their retirement plan offering. The emergency savings account assets are invested in low-volatility investments, such as money market funds or stable value accounts.

With this sidecar emergency savings in place, plan participants can save for emergencies automatically, similar to how they save for retirement, using pre-tax dollars for the retirement plan, and after-tax dollars for their emergency account. They can also easily track the accumulation of those assets on their regular retirement account statement. Offering these accounts is a great way for plan sponsors to help employees overcome the inertia that can prevent them from taking important steps to help improve their financial health.

CONCLUSION

In moving towards financial wellness, creating a budget is an important first step. Budgets help individuals understand expenses in order to develop a road map for where income is spent while also saving for the future. However, even with a budget, unexpected expenses can derail any financial program, if there is no plan in place. This is where an emergency savings account can be instrumental in enabling employees to maintain their financial focus. Plan sponsors should speak with their retirement plan provider to learn more about what they can offer.

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For more information on our services, please contact **Earle Allen,** Partner, at **646.839.8206** or **eallen@cammackretirement.com**.

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