THE NEED FOR EMERGENCY SAVINGS

Revamping Retirement Podcast | Episode 18

CAMMACK RETIREMENT

PSCA
Plan Sponsor Council of America

INTRODUCTIONS

The Need for Emergency Savings

- **Jack Towarnicky** is building American Retirement Association's (ARA) research capabilities
- Previously, he served as the Executive Director at the Plan Sponsor Council of America (PSCA) during a critical period of integration with the ARA
- Before PSCA, Jack served as a human resources/benefits leader at four different Fortune 500 firms, and as a compliance/consulting attorney
- Industry group and trade association affiliations:
  - The Department of Labor's ERISA Advisory Council
  - Board positions at:
    - World at Work's Benefits Advisory Board
    - American Benefits Council
    - Council on Employee Benefits
    - International Foundation of Employee Benefit Plans, Corporate Board

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THE NEED FOR EMERGENCY SAVINGS

RESOLVED:
Retirement Plan Sponsors Should Consider Offering Automated Emergency Savings Funds

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EMERGENCY SAVINGS: RESOLVED

The Need for Emergency Savings

WHY OFFER EMERGENCY SAVINGS ACCOUNTS?

- Individuals with emergency funds are far more likely to use those funds in an emergency instead of borrowing/withdrawing from their retirement savings plan, avoiding leakage
- Individuals with emergency funds are in a better financial position to save for retirement

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EMERGENCY SAVINGS: RESOLVED

The Need for Emergency Savings

EMERGENCY SAVINGS AND RETIREMENT SAVINGS GO HAND-IN-HAND

- Automated retirement savings and emergency savings are similar; so, once participants are acclimated to one process, they are more likely to participate in both
- Automated emergency savings programs are relatively easy to establish and integrate into an existing voluntary benefits program or as a “sidecar” to the retirement savings plan

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THOSE ALREADY CONTRIBUTING TO RETIREMENT ARE UNLIKELY TO STOP

- Unlikely that people will stop saving for retirement in order to start an emergency fund
- The point of these funds (like a retirement plan) is to take money out of your account before you have a chance to miss and/or spend it, ultimately helping to save for a future need

EMERGENCY SAVINGS: RESOLVED

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IMPROVED FINANCIAL HEALTH IMPROVES ABILITY TO SAVE FOR RETIREMENT

- Some people not currently saving for retirement may opt to start an automated emergency fund, since the process is easier than opening an Individual Retirement Account (IRA) or completing a salary reduction agreement for a retirement savings plan
- By improving employee overall financial health through the establishment of an emergency savings fund, plan sponsors are improving employees' capacity to save for retirement in the future

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EMERGENCY SAVINGS FUNDS SHOULD BE KEPT SEPARATE

- While a retirement plan loan can serve as an "emergency fund," problems arise when an individual exhausts loan eligibility
- COVID-19 withdrawals will not always be available and are unlikely to be paid back
- Hardship withdrawals are a terrible option
- Many employees access funds at the worst possible time — early in their careers — when the power of compounding is the most magical!

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THE NEED FOR EMERGENCY SAVINGS

RESPONSE:

"Sidecar" Emergency Savings are a Suboptimal Solution for Retirement Plan Sponsors and Participants

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EMERGENCY SAVINGS: RESPONSE

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“SIDECAR” EMERGENCY ACCOUNTS ONLY MAKES SENSE IF:

- No 401(k), 403(b), or 401(a) **AND**
- No plan “liquidity without leakage” (a.k.a. plan loans) **AND**
- Roth IRA already fully funded

PLAN SPONSORS SHOULD FIRST AND PRIMARILY FOCUS ON MAXIMIZING PARTICIPATION AND CONTRIBUTIONS – WHILE ALSO OFFERING “LIQUIDITY WITHOUT LEAKAGE”

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EMERGENCY SAVINGS: RESPONSE

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401(K) OR 403(B) OR 401(A) **ALWAYS SUPERIOR, ALWAYS**:

- Account grows more quickly
  - Tax preferences
  - Employer financial support
- “Fleeting” opportunity to save
  - Employer-sponsored plan
  - Current plan year
- Emergency may never arrive
- Once used, account must be replenished
- Plan loans are naturally “perennial”
- Loan principal = fixed income investment in the participant

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EMERGENCY SAVINGS: RESPONSE

The Need for Emergency Savings

Element	Proposed Sidecar	Typical 401(k)
Employee Contribution	$ 750	$ 1,000
Reduction in Take Home Pay	$ 750	$ 750
Wages (assuming 25% marginal rate)	$ 1,000	$ 1,000
Employer Contribution	$ -	$ 500
Invested Assets	$ 750	$ 1,500
One Year's Earnings		
- Money Market (2%)	$ 7.50	$ -
- Target Date (6%)	$ -	$ 45
Assets Available for Emergency		
- Withdrawal	$ 757.50	
- Loan		$ 1,545

Source: Author's calculations

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WHY USE A 401(k) AS AN EMERGENCY ACCOUNT?

- On average, 15% - 20% of eligibles **fail to save**
- Of the 80% - 85% who do save:
  - 33+% **fail to save enough** to get full match
  - plenty of capacity - **few maximize savings**

Source: Vanguard, How America Saves, 2020

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15% TO 20% OF ELIGIBLES DON'T SAVE – **LOSE EMPLOYER SUPPORT**

Plan participation rate	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 estimated
90%–100%	21%	24%	29%	31%	35%	40%	41%	44%	47%	49%
80%–89%	31	31	28	30	28	25	24	23	23	22
70%–79%	19	17	17	14	14	14	13	12	11	10
60%–69%	12	12	10	9	9	8	9	8	7	8
50%–59%	7	7	7	7	6	5	5	6	5	5
<50%	10	9	9	9	8	8	8	7	7	6
Average plan participation rate	76%	77%	78%	78%	79%	81%	81%	81%	82%	83%

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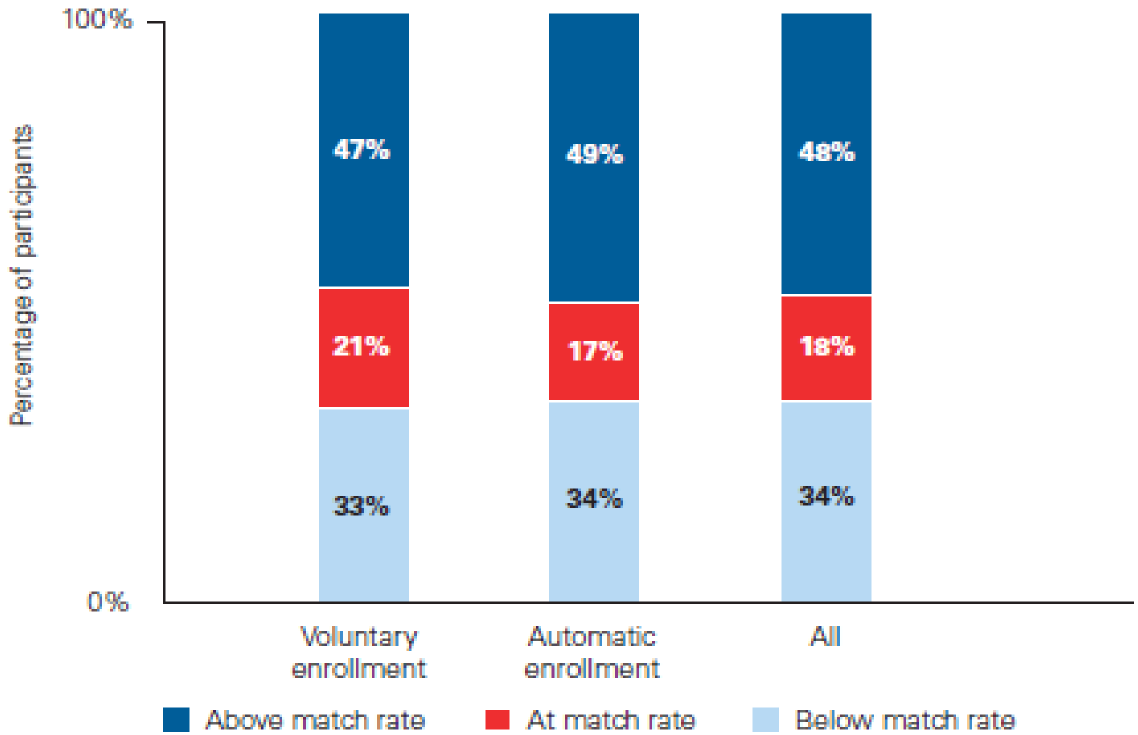
1/3 DON'T SAVE ENOUGH – **DON'T RECEIVE FULL EMPLOYER MATCH**



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FEW CONTRIBUTE THE MAXIMUM – **ALMOST NO NHCEs**

All	12%
Income	
<$15,000	1%
$15,000–$29,999	<0.5
$30,000–$49,999	<0.5
$50,000–$74,999	1
$75,000–$99,999	4
$100,000–$149,999	19
$150,000+	57

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SIDECAR SAVINGS IS **ALMOST ALWAYS INFERIOR**

- Emergency may never come
- No opportunity to deploy truly automatic features
- As account increases … so do financial/tax inefficiencies
  - No tax preference on contributions
  - No employer financial support
  - Very low interest rates
  - Interest currently taxable at marginal tax rate
- Must be replenished once used
- Lose "income average" opportunity

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Source: Vanguard, How America Saves, 2020

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THE NEED FOR EMERGENCY SAVINGS

AGREEMENT:
Emergency Savings is Essential to Financial Wellness

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The Need for Emergency Savings

EMERGENCY SAVINGS IS ESSENTIAL TO FINANCIAL WELLNESS

- 70+% of workers would have some or significant financial difficulty if their next paycheck **was delayed for one week**[1]
- Of those who had access to an employer-sponsored retirement savings plan **86% were contributing**[2]

[1]American Payroll Association, Getting Paid In America, September 2019

[2]Vanguard, How America Saves, 2020

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THE TYPICAL 401(k) IS **NOT** DESIGNED FOR EMERGENCIES

- Hardship withdrawal prevalence – 76%, 88% … ~3% took hardship withdrawals in 2019, up 48% over 2018
- Plan loan prevalence – 84%, 78% … 13% had outstanding loans, average balance = $9,900, equal to about 1% of aggregate plan assets
- Few allow after-tax 401(a), deemed IRA “sidecars”

Source: PSCA, 62nd Annual Survey of Profit Sharing, 401(k) plans, Vanguard, How America Saves, 2020

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The Need for Emergency Savings

MOST 401(k) PLANS HAVE LIQUIDITY PROVISIONS THAT ARE COUNTER-PRODUCTIVE, INEFFECTIVE IN MEETING EMERGENCY NEEDS

- Hardship withdrawals taxed at top marginal rates
- 401(k) plan loan processing is substandard – **few plans**:
  - Use a line-of-credit structure, most limit loan number
  - Use behavioral economics processes/strategies
  - Facilitate loan "rollover" from predecessor plans
  - Use 21st Century electronic banking/ACH processes:
    - Loan repayment is usually accelerated at separation
    - Few offer post-separation loans (taxable payout only)

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MORE THAN 95% WON'T RETIRE FROM THEIR CURRENT EMPLOYER

- Turnover is significant:
  - Median tenure for past 5+ decades for those ages 25 – 64 is < 5 years, less for those < age 25
  - Average of 12 employers (age 50 in 2016)
  - Most have different employer at age 62 vs. age 50
- Turnover becomes:
  - A leakage opportunity
  - Many access funds at/after separation

Source: Labor Department, Bureau of Labor

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The Need for Emergency Savings

PRESERVING ASSETS IS ESSENTIAL, NEEDS IMPROVEMENT:

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Percentage of participants choosing										
Remain in plan	48%	49%	48%	49%	49%	51%	50%	51%	48%	46%
Rollover	22	21	21	22	22	20	19	18	18	18
Installment payments	<0.5	<0.5	<0.5	<0.5	<0.5	<0.5	<0.5	<0.5	<0.5	1
Participants preserving assets	**70%**	**70%**	**69%**	**71%**	**71%**	**71%**	**69%**	**69%**	**66%**	**65%**
Cash lump sum	28%	28%	29%	28%	28%	28%	30%	30%	33%	34%
Rollover and cash	2	2	2	1	1	1	1	1	1	1

Source: Vanguard, How America Saves, 2020

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The Need for Emergency Savings

EXISTING TAX CODE, ERISA AND ASSOCIATED REGULATIONS ALLOW FOR PLAN DESIGNS THAT:

- **Encourage savings**
- Offer "**liquidity without leakage**," even after separation
  - Limiting liquidity may prompt reduced savings – participants may limit contributions to those amounts they are willing to earmark for a distant, uncertain, retirement
    - Lacking liquidity, many will not save enough
- Plan sponsors, service providers and advisors need to be attentive to financial needs "along the way" to retirement.

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THANK YOU

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