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David Newville, Director of Federal Policy
Email: dnewville@prosperitynow.org | Phone: 202.207.0147

Joanna Ain, Senior Policy Manager
Email: jain@prosperitynow.org | Phone: 202.595.2619

Helping Families Save to Withstand Emergencies

Many American Families Don't Have Emergency Savings

More than one-third of households lack savings to withstand a financial shock. The *Prosperity Now Scorecard* shows that 37% of households are in liquid asset poverty (LAP), meaning they do not have enough short-term savings to cover three months of basic living expenses in the event of a sudden job loss, medical emergency or other crisis.[1] Households of color are particularly affected by liquid asset poverty. Among households of color, 51% are liquid asset poor, compared to 28% of White households. LAP rates are particularly high for Black (57%) and Hispanic (61%) households.[2]

ALMOST HALF OF AMERICANS DON'T HAVE $400 FOR EMERGENCIES

SOURCE: Report on the Economic Well-Being of U.S. Households in 2017, *Board of Governors of the Federal Reserve System*, 2018.

Without savings, people have few options in an emergency. Nearly half of people without savings say they would be forced to borrow money in a financial emergency, either from a friend or family member (26%), bank or other source of mainstream credit (9%), or predatory payday lenders (5%).[3] (Payday lenders, which are much more expensive than bank loans, extract more than $9 billion a year in fees from vulnerable communities.)[4] Another 29% say they would be unable to fund a $400 emergency expense at all.[5]

Financial stability is a serious concern for many families. 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.[6] A major driver of concern is living paycheck to paycheck, 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.[7] 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.

Short-term savings build long-term financial wellbeing. When families have 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 helps people feel secure about putting money in restricted retirement accounts and makes them less likely to withdraw retirement funds early—incurring fees and reducing an important nest egg.[8] Savings also enable economic mobility: savers are more likely to move into a higher income quartile.[9] Children in low-income households whose parents have savings tend to earn more than their parents later in life.[10]

Key moments, 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.

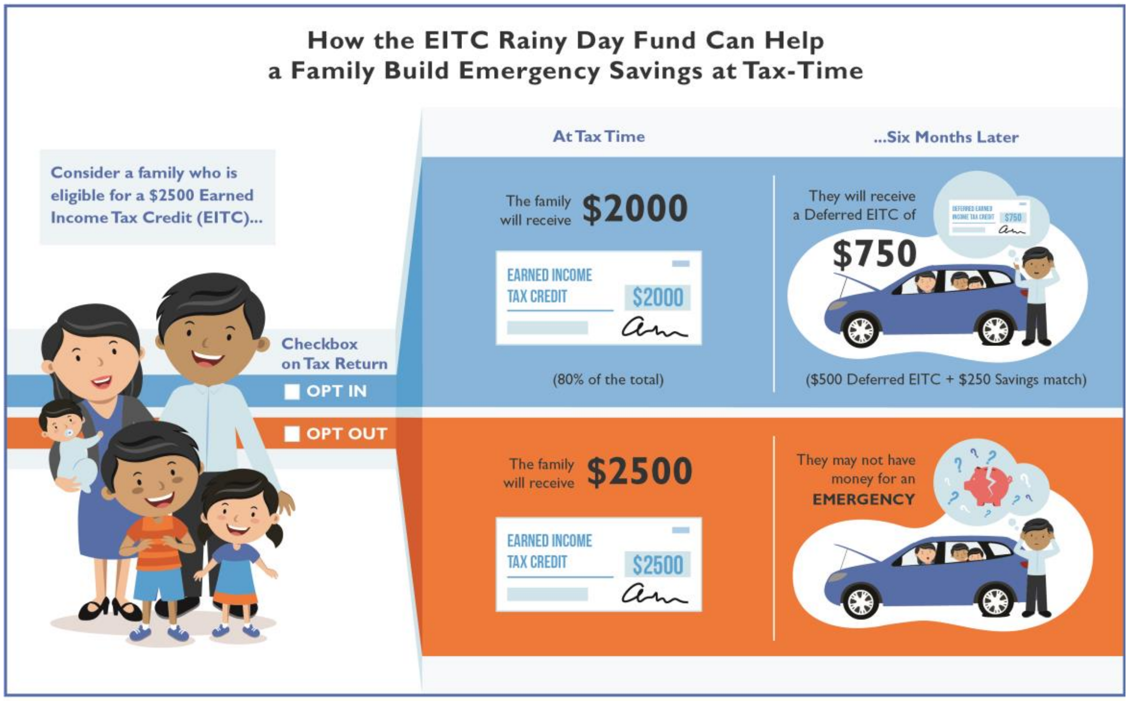
Tax Time is an Opportunity to Build Savings

Tax time is particularly important in the financial calendar of families that receive the Earned Income Tax Credit (EITC). In 2017, 27 million workers claimed an average $2,445 in EITC benefits, delivered as lump-sum payments through families' tax refunds.[11] Combined with the Child Tax Credit (CTC), the EITC lifted 8.1 million people out of poverty in 2016.[12] The EITC has been tied to significant positive outcomes, including improved infant health, school performance and earnings for the next generation.[13]

Tax refunds are essential to working families' financial stability. For low- and moderate-income families, tax refunds—including money transferred via the EITC—often account for as much as one-fifth of annual income, the equivalent of three months' wages.[14] Income from a tax refund can be used for important purchases and 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. Families also use these refunds to buy big-ticket items, like household furniture or putting a downpayment on a car for driving to work.[15]

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. 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 does not incentivize saving for emergencies. The tax code encourages retirement saving 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 $0. This means the Saver's Credit generally benefits only wealthier people who do not benefit from programs like the EITC or CTC.[17] 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.[18] 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. Five states (California, Connecticut, Illinois, Maryland and Oregon) are addressing the access problem with "Auto-IRA" policies that enroll workers who do not have access to retirement savings in state-sponsored Individual Retirement Accounts (IRAs).[19]

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.[20] 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 short-term savings accounts 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 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.[21] Under current law, with little administrative effort, workplaces could set up short-term savings accounts as part of a 401(k) plan, which would protect workers' investment and could allow employees to automatically deduct savings from their paychecks. This can be done within, alongside or even separately from a retirement plan, such as a 401(k).[22]

Congress Can Help Families Save

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

- **Enhance the EITC to make saving easier.** Congress should pass the Refund to Rainy Day Savings Act (S. 3221), introduced in July 2018 by a bipartisan group of senators. Sponsored by Sens. Cory Booker (D-NJ), Tom Cotton (R-AR), Heidi Heitkamp (D-ND) and Todd Young (R-IN) as part of a package of savings bills, 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 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 and other incentives to help low-income workers save their own money and build assets.[23]

- **Pass legislation supporting workplace emergency savings, as well a nationwide Auto-IRA program.** Legislation already proposed in Congress would encourage employers to offer emergency savings as a benefit to their workers and increase access to retirement savings for Americans who do not have access to workplace-based plans:

    - The Strengthening Financial Security Through Short-Term Savings Plans Act (S. 3218), proposed by Sens. Booker, Cotton, Heitkamp and Young as part of their savings package, would make it easier for employers to offer rainy day savings accounts to workers completely separate from any retirement accounts that may or may not be offered. These accounts would help workers build short-term savings through automatic contributions, allowing families to prepare for the unexpected.

    - Passing the Automatic IRA Act of 2017 (S. 1861, H.R. 3499), proposed by Sen. Sheldon Whitehouse (D-RI) and Rep. Richard Neal (D-MA-1), would increase access to retirement savings by requiring employers without retirement plans to make an IRA available to workers.[24] This expands upon work done in states to make IRAs available to workers. Access to an IRA reduces barriers to saving for many families. Though not included in the proposed legislation, Auto-IRA could be expanded in the future to include emergency savings accounts as well.

- **Reform and enhance the Saver's Credit.** In its current form, the Saver's Credit is too constrained to help many working families. The Saver's Credit would better help American families if it was fully refundable, allowing lower-income households to receive a larger tax refund. Additionally, the credit should be extended to incentivize rainy day savings, as well as retirement savings. Finally, Congress should tie the maximum credit to inflation so that the benefits of the Saver's Credit increase with the economy and prices. By passing legislation to reform the Saver's Credit, Congress would help more low-income families benefit from the program and encourage short-term saving. Because higher-income households are disproportionately White and low-income workers are more likely to be Black and Latino, extending this credit to low-income workers can also help reduce the racial wealth divide.

This brief was written by Michael Auslen.

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