Center for Financial Security
Family Financial Security Webinar Series
October 11, 2011

Coming Up with Cash in a Pinch: Emergency Savings and its Alternatives

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Coming Up with Cash in a Pinch: Emergency Savings and Alternatives

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J. Michael Collins
Leah Gjertson

October 11, 2011
Overview

- Literature review of studies on savings and use of debt to make ends meet
  - over 80 studies reviewed
- Thinking about Role of Savings
- Context for use of liquidity mechanisms
- Policy Implications
Emergency Savings: Due to drop in income; Increase in expenses

Rainy day fund to cover unexpected or expected but variable events
  - Form of Insurance - basically offer some ‘liquid’ resource

Relatively small amounts compared to long-term savings for retirement or education savings

Different from precautionary savings due to variability in expected income
# Forms of Liquidity

## Table 2

### Summary of Liquidity Mechanisms

<table>
<thead>
<tr>
<th>Type</th>
<th>Pro (+)</th>
<th>Con (-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Checking Account</td>
<td>Convenient</td>
<td>Overdraft fees costly if withdraw more than account balance</td>
</tr>
<tr>
<td>Savings Account</td>
<td>Convenient</td>
<td>Minimum balance required; limits on withdrawals</td>
</tr>
<tr>
<td>A. Informal Lending</td>
<td>Convenient; Underwriting and Collections efficiencies</td>
<td>Relationship based</td>
</tr>
<tr>
<td>B. Late or Skipped Payment</td>
<td>Convenient</td>
<td>Undermines credit history; may lose other accounts</td>
</tr>
<tr>
<td>C. Payday Loan</td>
<td>Convenient advance of short run income</td>
<td>Requires bank account; costly if used repeatedly</td>
</tr>
<tr>
<td>D. Pawnshop</td>
<td>Can liquidate durable goods or personal property</td>
<td>May be costly; may lose property</td>
</tr>
<tr>
<td>E. Auto Title Loan</td>
<td>Convert equity in auto to current consumption; Collateralized</td>
<td>May be costly; may lose vehicle</td>
</tr>
<tr>
<td>F. Refund Anticipation Loan</td>
<td>Can convert tax refund to consumption</td>
<td>Short term loan once per year; May be costly</td>
</tr>
<tr>
<td>G. Credit Card</td>
<td>Convenient;</td>
<td>Terms vary; Qualifications standards vary</td>
</tr>
<tr>
<td>H. Retirement/401(k) Loan/ Liquidation</td>
<td>Low cost loan; May be significant assets</td>
<td>Access varies; nonpayment carries tax penalty; Loss of retirement security</td>
</tr>
<tr>
<td>I. Whole Life Insurance Cash Value Loan</td>
<td>Low cost loan</td>
<td>Access varies</td>
</tr>
</tbody>
</table>
Figure 2

*Emergency Funds and Drop in Income*

Source: FINRA Financial Capability Survey, State Sample, National weights. Authors’ tabulations.
Figure 3

Account Holding by Income, 2009

Source: FINRA Financial Capability Survey, National data, Published tables.
Table 1

*Percent of Households by Income with Financial Asset or Debt, 2009*

<table>
<thead>
<tr>
<th>Income Range</th>
<th>Any Financial Asset</th>
<th>Transaction accounts</th>
<th>Certificates of deposit</th>
<th>Savings bonds</th>
<th>Cash value life insurance</th>
<th>Any debt</th>
<th>Credit card balances</th>
<th>Installment loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 20</td>
<td>83%</td>
<td>77%</td>
<td>9%</td>
<td>4%</td>
<td>15%</td>
<td>56%</td>
<td>28%</td>
<td>33%</td>
</tr>
<tr>
<td>20–39.9</td>
<td>94%</td>
<td>91%</td>
<td>14%</td>
<td>10%</td>
<td>22%</td>
<td>73%</td>
<td>38%</td>
<td>51%</td>
</tr>
<tr>
<td>40–59.9</td>
<td>97%</td>
<td>95%</td>
<td>14%</td>
<td>12%</td>
<td>22%</td>
<td>84%</td>
<td>51%</td>
<td>57%</td>
</tr>
<tr>
<td>60–79.9</td>
<td>100%</td>
<td>100%</td>
<td>19%</td>
<td>21%</td>
<td>26%</td>
<td>88%</td>
<td>57%</td>
<td>58%</td>
</tr>
<tr>
<td>80–89.9</td>
<td>100%</td>
<td>99%</td>
<td>21%</td>
<td>25%</td>
<td>32%</td>
<td>89%</td>
<td>52%</td>
<td>56%</td>
</tr>
<tr>
<td>90–100</td>
<td>100%</td>
<td>100%</td>
<td>26%</td>
<td>24%</td>
<td>41%</td>
<td>84%</td>
<td>32%</td>
<td>41%</td>
</tr>
</tbody>
</table>

Source: Survey of Consumer Finances (Bricker, Bucks, Kennickell, Mach & Moore, 2011)  
Why Don’t Low-income People Have Emergency Savings?

- Too hard to save when all of income is needed for consumption
- Lack of low-cost savings mechanisms
- Program rules restrict asset holding
- Legal issues: garnishment, judgements
- Behavioral failures (procrastination, present-bias)
- More study needed
How to Emphasize Emergency Funds

- Remove penalty for having 3-6 months of income as savings
- Low fee savings accounts with some constraints but can be tapped when needed
- Better recognition of and planning for lumpy expenditures (may underestimate such needed)
- Caution: Eliminate alternative sources of liquidity and household will find cash some other way
Pamela Chan
Senior Policy Analyst
Asset Building Program
New America Foundation
Making Saving a Reality

Public Policy Actions to Support Emergency Savings Opportunities for Lower-Income Households
Presentation Guide

- About the New America Foundation
- “Coming Up with Cash in a Pinch” Contributions
- The Need for Emergency Savings
- Barriers to Emergency Savings
- Approach to Address Barriers
- Policies to Enhance Key Savings Opportunities
About the New America Foundation

- Nonprofit, nonpartisan public policy institute
- Main office in Washington, DC
- Sampling of issues covered

<table>
<thead>
<tr>
<th>Domestic</th>
<th>Economic</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets &amp; Ownership</td>
<td>Economic Growth</td>
<td>Foreign Policy</td>
</tr>
<tr>
<td>Education</td>
<td>Federal Budget</td>
<td>National Security</td>
</tr>
<tr>
<td>Health</td>
<td>Fiscal Policy &amp; Taxes</td>
<td>Terrorism</td>
</tr>
<tr>
<td>Media &amp; Public Opinion</td>
<td>Social Contract Initiatives</td>
<td>Climate Change</td>
</tr>
<tr>
<td>Workforce &amp; Family</td>
<td>Trade &amp; Globalization</td>
<td>Microfinance</td>
</tr>
<tr>
<td>Telecom &amp; Technology</td>
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</tbody>
</table>
About the Asset Building Group

- Mission is to broaden access to economic resources through increased savings and asset ownership

- Collect, synthesize and disseminate resources and policy ideas on a variety of related topics such as personal savings, economic security, economic mobility, and asset building opportunities

- Current projects include the initiatives to improve savings opportunities over the life course (ASPIRE Act, Saver’s Bonus Act, the AutoSave Pilot, Universal IRAs Proposal) and the Congressional Savings & Ownership Caucus
“Coming Up with Cash in a Pinch”
Paper Contributions

• Reviews of the importance of emergency savings on financial stability

• Refocuses asset building field on the immediate savings needs of low- and moderate-income households

• “The costs of [quick credit products] appear to be high on an absolute level. Yet continued household demand for these products suggest an underlying need for liquidity that these markets are trying to access.”
The Need for Emergency Savings

• While the paper explains why people need liquid savings, a major question remains: How much is needed?

• No definite answer, but there is evidence available to show that even a relatively small amount helps
  • **Consumer Federation of America Survey:** Lower-income households with at least $500 in emergency savings were significantly less likely to report that they experienced an unfavorable financial events compared to households with less than $500 in emergency savings
  • **Urban Institute Study:** Significantly reduced incidence of material hardship among even the lowest-income households with liquid savings below $2,000 compared to households with none
Barriers to Building Emergency Savings

- Limited economic resources to save
- Increased challenges to assert willpower
- Low availability of suitable savings products
- Lack of access to savings and financial management tools
- Little to no public policy to support the need
Approach to Address Barriers

1. Identify key savings opportunities
2. Determine what interventions are most appropriate
3. Assess the role of policy in supporting the interventions
4. Advocate for the implementation of policy
Savings Opportunity: Tax Time

**Opportunity**
- Potentially largest influx of cash of the year
- Broad reach among LMI households

**Interventions**
- Long history of asset building initiatives at VITA sites
- D2D Savings Bond pilots
- $aveNYC & SaveUSA demonstrations

**Policy**
- Saver’s Bonus Act
- Improve access to a variety of liquid savings products through tax filing process

**Advocacy**
- Working with Congress to re-introduce
- Grassroots campaign with RESULTS
- Work with Treasury on MyAccountCard pilot
- Partner on Savings Bond Working Group
Savings Opportunity: Workplace

Opportunity
- Primary source of income
- Existing payroll system for auto-savings

Interventions
- AutoSave Pilot
- Precautionary Savings Investment in IRA or 410(k) Portfolios

Policy
- Expand use of direct deposit and split pay
- Allow for non-retirement auto-savings structures
- Currently exploring since retirement programs are time restricted and extremely complex

Advocacy
- Provide insights on direct deposit, savings accounts and workplace savings programs to regulators, employers, regional asset building coalitions & financial service providers
Savings Opportunity: Public Assistance Programs

<table>
<thead>
<tr>
<th>Opportunity</th>
<th>Interventions</th>
<th>Policy</th>
<th>Advocacy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rental Housing Assistance Asset Accounts</td>
<td>Offer Savings Accounts through Benefits Programs</td>
<td>• Expansion of the Family Self Sufficiency program</td>
</tr>
<tr>
<td></td>
<td>• Increasing delivery of benefits through electronic means</td>
<td></td>
<td>• Allow for reloading</td>
</tr>
<tr>
<td></td>
<td>• Trend towards relaxed assets limits</td>
<td></td>
<td>• Include a savings pocket</td>
</tr>
<tr>
<td></td>
<td>• Captures many of the most underserved households</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# Savings Opportunity: Financial Service Providers

<table>
<thead>
<tr>
<th>Opportunity</th>
<th>Interventions</th>
<th>Policy</th>
<th>Advocacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Most mainstream place for asset building</td>
<td>• Small dollar bank savings account</td>
<td>• Incentivize provision of low-cost, basic savings products</td>
<td>• Provide comments on financial services issues to Treasury</td>
</tr>
<tr>
<td>• Most likely to have widest reach</td>
<td>• Prepaid savings pockets &amp; other alternatives</td>
<td>• Reduce enrollment barriers to accounts</td>
<td>• Collect and share provider and consumer insights with financial services regulators (CFPB, FDIC, FRB)</td>
</tr>
<tr>
<td></td>
<td>• Financial management tools &amp; services</td>
<td>• Support marketing and promotional campaigns</td>
<td>• Collaborate with BankOn and America Saves partners</td>
</tr>
</tbody>
</table>

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*Note: The original content is not provided, but the table structure and the content of the summary are clearly visible.*
Savings Opportunity: Community-Based Services

Opportunity
- One-on-one counseling is effective in helping families create and execute a financial plan
- Limited capacity of current network of non-profit financial advising/coaching providers

Interventions
- New York City Financial Empowerment Centers
- The Financial Clinic Fellows Program
- NCLR Homeownership Network

Policy
- Continue collating and disseminating research on financial capability & counseling building best practices
- Establish a “financial services corps”

Advocacy
- None at this time, but desire to maintain an active conversation with interested parties
Contact Information

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• New America Foundation

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• 202-596-3350
• www.newamerica.net
The Financial Clinic

Mae Watson Grote
Executive Director
The Financial Clinic

- **Mission:**
  The Clinic exists to build the financial security of working poor families. We do this by addressing their immediate financial challenges and helping them create trajectories for achieving long-term goals and financial mobility.

- **Accomplishments:**
  - $3.5 million returned in assets and resources to 7,000 customers with an additional $10 million in refunds at our tax project
  - In 2011, 21 staff members will assist 4,000 families (not including our tax filers) across all 5 boroughs and Newark at 25 sites
The Clinic exists to build working poor people’s financial security. Our **financial development** model helps customers address their immediate financial challenges, while working toward long-term goals and financial mobility.
Clinic Customers

Impact of Great Recession
- 26% have lost a job;
- 17% experienced a pay cut while still employed;
- 14% had excessive medical bills;
- 46% applied for or received food support;
- 21% applied for or received rental support; and
- 50% of all respondents applied for or received Medicaid.

Financial Insecurity
- Clinic customers’ average annual income $17,000; (self sufficiency standard is mid-$60,000s);
- Two-thirds of customers have overwhelming debt or bad credit as presenting issue; and
- 27% paid their bills after the due date often or almost always.

Little to No Emergency Savings
- 40% had no savings;
- 19% had between $1 and $100 in savings; and
- 17% had between $100 and $500 in savings.
How Did Clinic Customers End Up Here?

**Market Failures**
- Health care crisis
- Job loss & unemployment
- Low earnings

**Situational Factors**
- Better budgeting
- Living beyond means
- Health crisis
- ID theft
- Lack of employable skills

**Policy Failures**
- Predatory products
- High cost products
- Lack of safety nets
- Asset tests
- Employers that use for credit reports

Clinic customers cope by acquiring patchwork jobs; doubling up; participating in sous sous; engage in bartering; and doing without necessary expenses.
Clinic Philosophy

Presenting Issue
- Overwhelming debt
- Bad credit history and score
- Legal issues

Financial Goals
- Action-oriented
- Forward-thinking
- Passionately-Held

Results
- Hard work of budgeting;
- Doing without;
- More outcomes;
- Higher uptake and retention
Contact Information

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Executive Director  
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Q&A
November Webinar

Tuesday, November 8th
1pm - 2pm CDT / 2pm - 3pm EDT

Encouraging the Use of Retirement Savings Contribution Credit through VITA Sites
Jonathan Spader, Abt Associates

For more information on the 2011 CFS Webinar Series: http://cfs.wisc.edu