ASSET BUILDING

NEW AMERICA

MAY 2015

FLEXIBLE SAVINGS:
THE MISSING FOUNDATION FOR FINANCIAL SECURITY AND ECONOMIC MOBILITY

Reid Cramer, Justin King, and Elliot Schreur

ABOUT THE AUTHORS

Reid Cramer is the director of the Asset Building Program at New America. Previously, he served as the program's research director and as a co-director of the New America Foundation's Next Social Contract Initiative. His work has provided analytical support for the development of a range of policy proposals, including the ASPIRE Act, a proposal to create a savings account for every newborn child in America. He is the co-editor of "The Assets Perspective: The Rise of Asset Building and it Impact on Social Policy" a multi-dimensional exploration of how the concept of asset building has taken shape over the last two decades.

Prior to joining New America, Dr. Cramer served as a policy and budget analyst at the Office of Management and Budget. He has worked for a range of nonprofit housing and community development organizations, the National Research Council, and the Urban Institute. He has a doctorate in public policy from the LBJ School of Public Affairs at the University of Texas at Austin, as well as a master's degree in city and regional planning from the Pratt Institute and a bachelor of arts degree from Wesleyan University.

Justin King is the policy director of the Asset Building Program at New America, which he joined in 2008. He leads the Asset Building Program's efforts to communicate with policymakers and the public. Prior to joining New America he worked in the United States Senate for former U.S. Senator James Jeffords (I-VT). He is a graduate of St. Lawrence University, where he earned a bachelor's degree in government.

Elliot Schreur is a Policy Analyst with the Asset Building Program at New America. He provides research and analysis on a range of policy areas relating to the economic advancement of low- and middle-income American households, focusing in particular on tax policy and retirement security. He holds a Master's Degree in public policy with a concentration in philosophy and social policy from the George Washington University and a Bachelor's Degree from the University of Richmond.

ABOUT THE ASSET BUILDING PROGRAM

The mission of the Asset Building Program is to significantly broaden access to economic resources through increased savings and asset ownership, thereby providing families with enhanced economic security, a direct stake in the commonwealth, and the means to pursue their aspirations.

*The authors would like to acknowledge the significant contributions of their colleagues Rachel Black and Patricia Hart in the writing, editing, and production of this paper.

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The ability of families to build up a financial cushion that can be tapped without penalty or restriction to meet unexpected expenses is a primary determinant of financial security and a key to future economic mobility. Being able to access flexible savings when expenses exceed income prevents an over-reliance on debt, decreases the likelihood of experiencing hardship, and promotes advantageous asset building over the long term. Yet many families are unable to amass even a small pool of flexible savings that can make a difference. Current public policy creates unnecessary barriers and offers insufficient incentives to support families in the process of accumulating strategically useful savings. The lack of flexible savings is a problem not only for lower-income families, but affects households at nearly all levels of income. While policy supports to help families build certain long-term assets, such as retirement savings and home equity, do exist at the federal level, there are no federal policy provisions to support flexible savings. Perhaps worse, families are penalized when they are forced by circumstance to draw down on their own savings that have accumulated in tax-preferred accounts. In light of growing evidence about the extent of financial insecurity among American households, policymakers should consider ways to support families' efforts to build flexible savings.

According to the findings of a focus group conducted by the Pew Charitable Trusts, ordinary Americans believe that financial security is having "enough money to pay the bills, a little left over for small extras or savings, and few worries about making ends meet."[1] In an ideal world, planning family finances to meet these needs would be clear-cut. Heads of households could look at their regular income streams and easily see how to keep expenses lower than income. But in the real world, incomes fluctuate, expenses occur irregularly, children get sick, and companies lay off workers. Being financially secure means being able to weather these types of life events. It's not enough to look at monthly balance sheets and compare income to expenses. In order to be financially secure over the life course, families must also plan for the inevitable financial emergencies and contingencies that—in the absence of appropriate precautions—threaten not only monthly balance sheets and immediate well-being, but also long-term financial security and prospects for economic mobility over the life course.

Given evidence about the precariousness of family finances, from volatile monthly income to inadequate retirement savings, an important step in improving family finances is to increase families' access to flexible savings. This paper will elevate the concept of flexible savings, discuss its role as a foundation for financial security and mobility, and make the case for policy action to remove barriers and create focused incentives. A series of policy reforms can help chart a new course that would allow American households to begin building their financial security on a foundation of flexible savings

[1] "Americans' Financial Security: Perception and Reality," (2015), Washington, D.C.: The Pew Charitable Trusts, p. 2.

that can meet the challenges of everyday life and promote productive investments in the household, the community, and the nation's economy as a whole.

AN INTRODUCTION TO FLEXIBLE SAVINGS

Financial liquidity is a necessity of modern life. In its most basic form, having liquid assets simply means having cash on hand to meet routine needs. It's how parents put food on the table, fill up the gas tank, and buy school supplies. But there are times when current income streams do not match current expenses. In the modern economy, incomes fluctuate and unexpected expenses arise. Many of these expenses can be reasonably predicted to occur over the course of a life, but still arise unexpectedly on an individual basis. Common examples are the costs of car repairs, urgent home maintenance, or illnesses that require out-of-pocket expenditures. Another set of expenses are not related to emergencies or misfortunes but are unanticipated opportunities for advancement, such as paying fees for a job certification or training program, putting down a security deposit for an apartment, or ensuring that children can access a valuable enrichment opportunity.[2] On the income side of the balance sheet, many families experience significant fluctuations year-over-year and month-over-month.[3] In order to avoid material hardship in these periods when expenses exceed income (hardships like experiencing food insecurity or the inability to pay bills), families must have access to financial liquidity.

Too few families have access to the kinds of unrestricted, flexible savings that are the most financially prudent sources of funds to use in a financial emergency.

For many financially distressed families, having access to financial liquidity inevitably means running up a credit card, borrowing from friends, or resorting to a payday lender.[4] For others, it means reaching into retirement savings, tapping home equity, or drawing down other long-term assets. Many of these assets are "investment-oriented," and the combination of complex access rules, fluctuations in account value, and tax penalties on withdrawals require the savings to remain untouched for maximum benefit.[5] Regrettably, too few families have access to the kinds of unrestricted, flexible savings that are the most financially prudent sources of funds to use in a financial emergency. These are assets like funds held in checking and savings accounts, assets held in safely invested post-tax retirement accounts (such as a Roth IRA) that incur no penalties for withdrawal and do not wildly fluctuate in value, low-cost prepaid cards, and plain old cash. With sufficient flexible assets to cover emergency expenses, families need not rely on high-cost options for short-term resources like payday loans, restricted-use savings accounts, or credit cards. And their most important lifetime assets like retirement nest eggs and home equity, which can help them move up the economic ladder in the long term, can be protected for future use.

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[2] "Emergency Savings Salon: Summary of Proceedings," (2013), Research Brief 2013-5.1, Center for Financial Security.

[3] "The Precarious State of Family Balance Sheets," (2015), Washington, D.C.: The Pew Charitable Trusts.

[4] According to the Board of Governors of the Federal Reserve, if faced with a $400 emergency expense, 16.9 percent of families would resort to charging a credit card and paying off the loan over time, 11.8 percent would borrow from friends or family, and 3.6 percent would take out a payday loan. "Report on the Economic Well-Being of U.S. Households in 2013," (2014), Washington, D.C.: Board of Governors of the Federal Reserve System, 88, table 89.

[5] Alejandra Lopez-Fernandini, (2010), "Unrestricted Savings: Their Role in household Economic Security and the Case for Policy Action," Washington, D.C.: New America.

Unfortunately, the current state of Americans' finances does not live up to this ideal. Flexible savings are too rare an asset on Americans' family balance sheets, and are insufficient when they exist at all. Liquid savings needs routinely exceed holdings for too many American households, and financial insecurity as a result of broader trends in the economy is a troubling reality across the country.

THE STATE OF FLEXIBLE SAVINGS IN AMERICA

Despite the country's relative affluence, financial insecurity remains a pervasive American dilemma. One characteristic of this problem is that typical households across all income levels lack a sufficient financial buffer to weather even minor setbacks. Three in ten American households do not possess a savings account at a bank, which in and of itself suggests widespread financial vulnerability.[6] A financial shock requiring less than one month of income would exhaust the liquid savings of the average household in the bottom four income quintiles. Even households in the highest 20 percent of income are at risk: the median amount of liquid savings for this highest-income group could not replace current expenses for a two month period.[7] Overall, only 39 percent of households report having set aside enough money in an emergency fund to cover expenses for three months.[8] And even including all other financial assets like retirement accounts and mutual funds, still 44 percent of households did not have enough resources to live at the poverty level for three months without income.[9] Among households of color, the share of families who could not survive at the poverty on financial assets is nearly 63 percent.[10] These actual savings levels run far below the standard advice offered by financial planners, who typically recommend that three to six months' worth of income be held in reserve.

> Among households of color, the share of families who could not survive at the poverty level for three months on financial assets is nearly 63 percent.

Households routinely underestimate their need for emergency savings, and, perhaps not surprisingly, they under-save. Households in the lowest income quintile perceive their emergency savings needs to be about $1,500 a year, but they typically end up spending $2,000 a year.[11] The median amount of savings in transaction accounts for this group is only $600.[12] Households in the next quintile perceive typical emergency savings needs to be $3,000,[13] but the median amount of assets in transaction accounts for this population is only $1,400.[14]

[6] "2013 National Survey of Unbanked and Underbanked Households," (2014), Federal Deposit Insurance Corporation.

[7] "The Precarious State of Family Balance Sheets," (2015), Washington, D.C.: The Pew Charitable Trusts, p. 11.

[8] "Report on the Economic Well-Being of U.S. Households in 2013," (2014), Washington, D.C.: Board of Governors of the Federal Reserve System, p. 18.

[9] "Liquid Asset Poverty Rate," (2015), Assets and Opportunity Scorecard, Washington, D.C.: CFED.

[10] Ibid.

[11] Stephen Brobeck, (2008), "The Essential Role of Banks and Credit Unions in Facilitating Lower-Income Household Saving for Emergencies," Washington, D.C.: Consumer Federation of America.

[12] "2013 Survey of Consumer Finances," (2013), Washington, D.C.: Board of Governors of the Federal Reserve System.

[13] Brobeck (2008).

[14] "2013 Survey of Consumer Finances" (2013).

THE ROLE OF FLEXIBLE SAVINGS IN PROMOTING FINANCIAL SECURITY

At the most fundamental level, flexible savings provide a means by which financially vulnerable families may avoid severe material hardship. The availability of flexible savings can decrease the likelihood that low-income households experience hardship when destabilizing events occur. Flexible savings can provide an immediately available resource pool to smooth over potential disruptions in consumption.[15] Low-income families who are liquid-asset poor are twice as likely to report increased hardship, such as food insecurity or inability to pay bills, compared to similar families with sufficient liquid assets.[16]

Though low-income, liquid-asset poor families may have the most urgent need for flexible savings in terms of avoiding acute material hardship, the unmet need for flexible savings is an issue for households at all ranges of the income scale. Volatility in both income and expenses has increased across the board in the past few decades.[17] In recent years, over four in ten households have seen their incomes fluctuate by at least 25 percent over a two-year period.[18] Contributing to these fluctuations is the fact that about 20 percent of the employed population works part-time.[19] Of these part-time workers, about a quarter are working part time for economic reasons, meaning that they would prefer full-time work.[20] This share of involuntary part-time workers appears to be part of a trend in the decline of control working Americans have over their income and expenses.[21]

Evidence about family finances reveals that this financial volatility contributes to increased strain on family balance sheets. In a recent survey, less than half of American households say they have both a steady income and consistent expenses, and eight in ten reports having faced an extraordinary expense, such as a hospital visit, car repair, or house repair.[22] Research from the U.S. Financial Diaries project illustrates how income and expense fluctuations put pressure on family balance sheets.[23] In response to irregular and asynchronous pay schedules from the multiple jobs many low-income families are forced to keep in order to make ends meet, some families, like those studied by the U.S. Financial Diaries

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[15] Gregory Acs, Pamela Loprest, and Austin Nichols, (2009), "Risk and Recovery: Understanding the Changing Risks to Family Incomes," Washington, D.C.: Urban Institute.

[16] Signe-Mary McKernan, Caroline Ratcliffe, and Katie Vinopal, (2009), "Do Assets Help Families Cope with Adverse Events?" Washington, D.C.: Urban Institute. (These researchers define "liquid assets" to include transaction accounts as well as mutual funds, savings bonds, retirement accounts, and all other financial assets. Being "liquid-asset poor" means having liquid assets totaling less than the amount required to live three months at the federal poverty line.)

[17] Peter Gottschalk and Robert Moffitt, (2009), "The Rising Instability of U.S. Earnings," *Journal of Economic Perspectives 23*(4), pp. 3-24; Olga Gorbachev "Did Household Consumption Become More Volatile?" *American Economic Review 101*(5), pp. 2248-2270.

[18] "The Precarious State of Family Balance Sheets," (2015), Washington, D.C.: The Pew Charitable Trusts.

[19] "Employed and Unemployed Full- and Part-Time Workers by Sex and Age, Seasonally Adjusted," (2015), Household Data Seasonally Adjusted, Table A-6, March 2015, Washington, D.C.: Bureau of Labor Statistics.

[20] "Employed Persons by Class of Worker and Part-Time Status," (2015), Household Data, Table A-8, March 2015, Washington, D.C.: Bureau of Labor Statistics.

[21] Rob Valletta and Leila Bengali, (2013), "What's Behind the Increase in Part-Time Work?" FRBSF Economic Letter 2013-08-26, Federal Reserve Bank of San Francisco.

[22] "Americans' Financial Security: Perception and Reality," (2015), Washington, D.C.: The Pew Charitable Trusts, p. 6.

[23] Jonathan Morduch and Rachel Schneider, (2013), "Spikes and Dips: How Income Uncertainty Affects Households," U.S. Financial Diaries.

project, routinely rely on relatively high-cost financial products, such as overdraft allowances and payday loans, in order to match current income with current expenses.[24]

Saving for the future is much more complicated for families that face irregular income and expenses than for households with more regular pay schedules and predictable expenses. Moreover, the whole process of budgeting and planning for the future is often a more difficult task when decision-makers are placed under the psychological strain of financial scarcity, a phenomenon that has recently been given prominence by researchers Sendhil Mullainathan and Eldar Shafir.[25] Scarcity leads people to put off financial decisions that "are important but not urgent," like those that could pay off in the future at a small short-term cost. The failure to accept these costs means that many families on tight budgets end up staying in a cycle of short-term surplus and short-term deficit with no long-term end in sight. The extent of Americans' experience with financial scarcity may be reflected in public attitudes about their financial needs. The Financial Diaries project found that 77% of families prioritized gaining "financial stability" over "moving up the income ladder."[26] In asking a similar question of the general public, Pew found that the difference was even starker: 92 percent valued financial stability over moving up the income ladder.[27]

EFFECTS OF THE LACK OF FLEXIBLE SAVINGS ON FAMILY FINANCES

Many American households are in danger of experiencing severe financial turmoil in the event of a financial shock. For significant expenses above the routine, or because of unexpected income dips, most American families would have to experience material hardship or rely on secondary—and less financially advisable—means of obtaining liquidity: reaching into retirement savings, tapping into home equity, taking out a payday loan, or running up a credit card.

Relying on these means to meet short-term needs is part of longer-term trends over the past 30 years, but has been intensified since the Great Recession, especially for lower-income families. Median net worth for American households has declined drastically since the recession, which puts increased strain on families trying to put together resources to meet immediate needs.[28] Overall, median household net worth declined 40 percent between 2007 and 2013, with a larger proportional decrease among households in the bottom three quintiles.[29] Much of this overall loss of wealth is due to the decline in value of nonfinancial assets in the form of home equity after the housing crash, but financial assets also saw a significant decline in value.

[24] Ibid., p. 6.

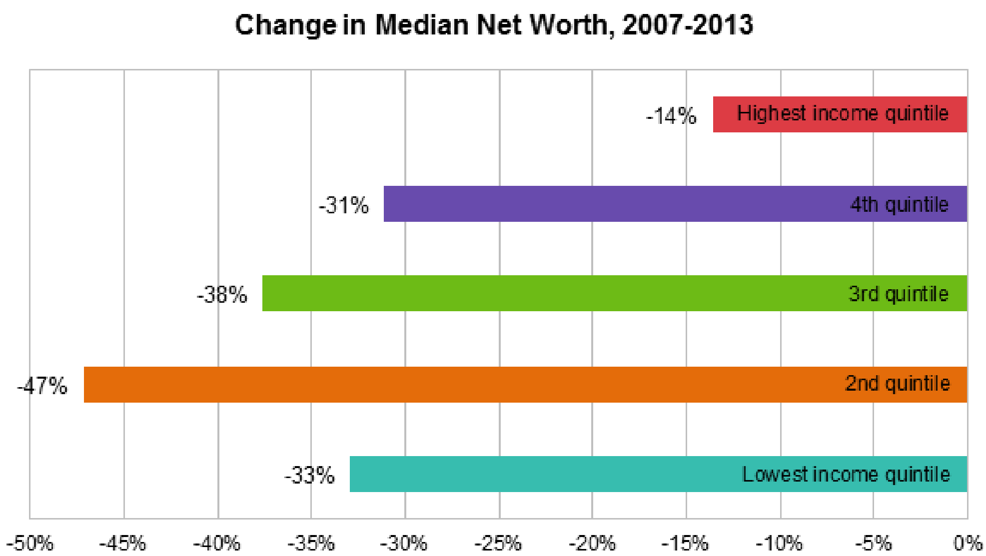
[25] Sendhil Mullainathan and Eldar Shafir, (2013), *Scarcity: Why Having Too Little Means So Much*, New York: Henry Holt.

[26] Jonathan Morduch and Rachel Schneider (2013), p. 6.

[27] "Americans' Financial Security: Perception and Reality," (2015), Washington, D.C.: The Pew Charitable Trusts, p. 7.

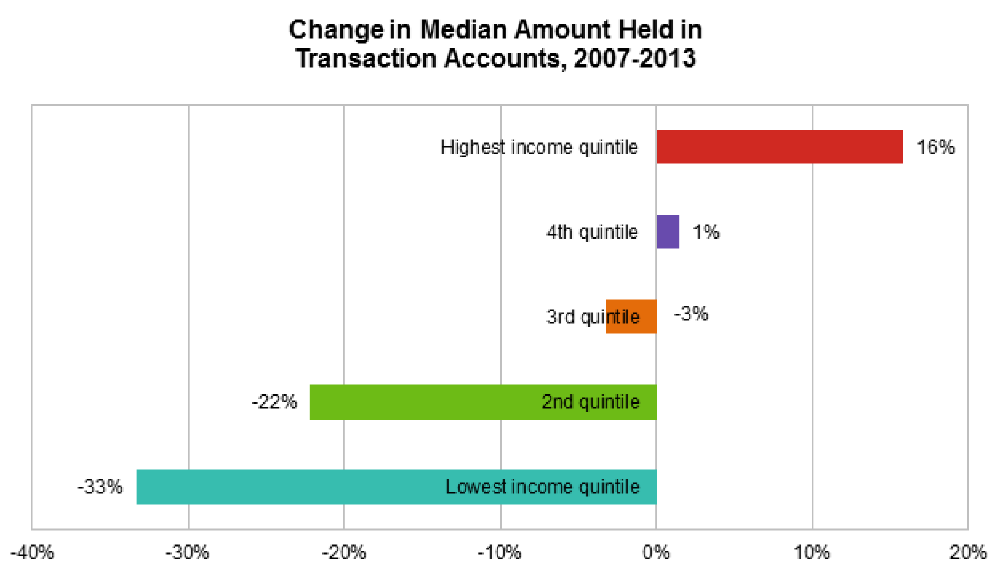
[28] See chart, "Change in Median Net Worth, 2007-2013."

[29] "2013 Survey of Consumer Finances" (2013).



Source: "2013 Survey of Consumer Finances," (2013), Washington, D.C.: Board of Governors of the Federal Reserve System.

Particularly notable for access to flexible savings has been a decline in the amount of assets held in accessible transaction accounts, especially among the lowest-income households.[30] The median amount held in a checking or savings account for families in the lowest income quintile with an account was $900 in 2007. This declined to a mere $600 after the recession in 2013.[31] While the absolute change of $300 may seem small, this decline represents a third of these families' holdings in transaction accounts, which significantly reduces their available flexible resources. Furthermore, this data point overestimates overall holdings among this population because only 79 percent of households in the bottom quintile own a checking or savings account in the first place.[32]

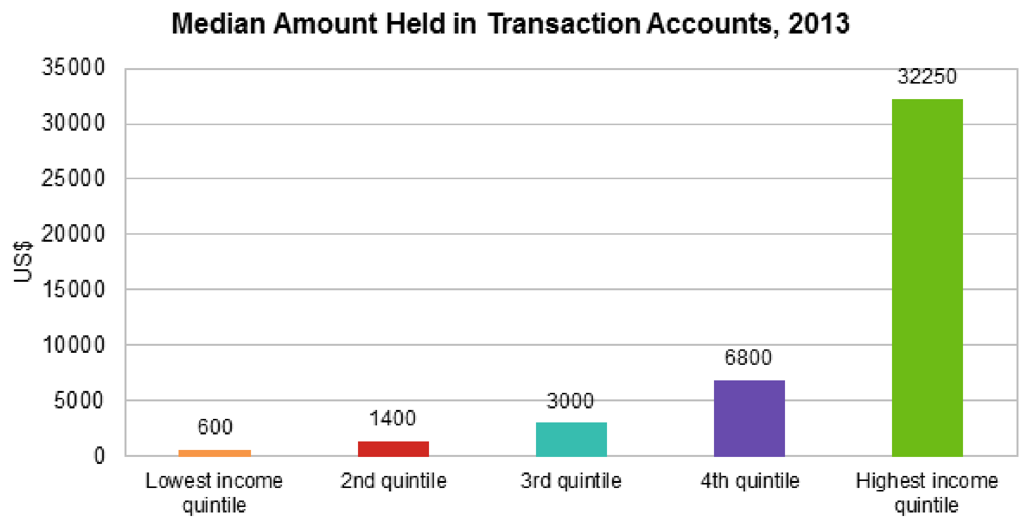


Source: "2013 Survey of Consumer Finances," (2013), Washington, D.C.: Board of Governors of the Federal Reserve System.

30 See chart: "Change in Median Amount Held in Transaction Accounts, 2007-2013."

31 See chart: "Median Amount Held in Transaction Accounts, 2013."

32 "2013 Survey of Consumer Finances" (2013).



Source: "2013 Survey of Consumer Finances," (2013), Washington, D.C.: Board of Governors of the Federal Reserve System.

In response to this decline in wealth and in holdings of accessible assets, it is understandable that families experiencing short-term financial needs would look to other resources besides the meager amounts in their transaction accounts. Many households look to their retirement nest egg. Households with insufficient emergency savings are about twice as likely to "breach" their retirement accounts as households with sufficient emergency savings. Specifically, three in ten households without sufficient emergency savings have used their retirement accounts for non-retirement needs, compared with 15 percent of households with sufficient emergency savings.[33] Furthermore, over one-quarter of workers making around the median U.S. income of $50,000 who participate in a 401(k) plan that allows loans have an outstanding loan balance on their account, in essence borrowing money from themselves.[34] These behaviors end up draining retirement account resources, but the phenomenon of account "leakage" reflects a reality that many families have a preponderance of non-retirement financial needs that must be met. The misalignment of savings needs and policy supports reveals the imperative for fundamental policy change to support flexible savings.

Another source of funds families often access when they cannot meet short-term needs with available short-term savings is credit. In the modern economy, heads of households can leverage a wide variety of assets to attain credit for short-term uses—at a cost. For example, financiers make short-term funds available to households based on anticipated paychecks or home equity. The widespread use of these assets to fund short-term expenses through the use of payday loans and home equity lines of credit (HELOCs) reveals the extent of the unmet need for flexible savings.

About 5 percent of American adults, approximately 12 million Americans, have used a payday loan. Households earning less than $40,000 a year are three times more likely than households earning more than $50,000 to have used a payday

[33] Matt Fellowes and Katy Willemin, (2013), "The Retirement Breach in Defined Contribution Plans: Sizes, Causes, and Solutions," Washington, D.C.: Hello Wallet. Breaches in this case are broadly defined to mean any use of retirement-account assets for short-term needs. This includes loans to the accounts that are eventually paid back, because this use of the accounts for short-term needs reveals an unmet need for short-term assets that endangers longer-term assets.

[34] Sarah Holden, Jack VanDerhei, Luis Alonso, Steven Bass, and AnnMarie Pino, (2014), "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2013," *ICI Research Perspective 20*(10), p. 53.

loan.[35] The percent of households that report using a payday loan in a single year has risen steadily since the recession, from 2.4 percent in 2007 to 4.2 percent in 2013.[36] Most distressing about the upward trend in the use of payday loans is that most borrowers report using payday loans to cover ordinary living expenses, suggesting that the use of high-cost credit is perceived by these households to be a necessary tool in family finances to bridge periods of mismatch between expenses and income.[37] The Consumer Financial Protection Bureau (CFPB) announced proposed regulations in March 2015 that would curb some of the most predatory practices of the industry and require lenders to take steps to ensure that consumers are able to repay the loan as a condition for being able to receive the loan.[38] Despite these potential regulatory changes, the new rules will not ban payday lending, nor will they be able to spur the creation of savings-based alternatives to high-cost short-term loans.

In the search for flexible financial resources, many families end up tapping one of the most promising vehicles for long-term asset accumulation: home equity. The forced savings mechanism of amortizing a mortgage and the potential of appreciating housing prices can make responsible homeownership a valuable proposition over the long term. Home equity accounts for about 63 percent of the net worth of middle-class families.[39] Yet without alternatives, families may opt to trade their built-up home equity for cash in order to meet unexpected expenses. While still below the peak during the recession, home-equity lines of credit (HELOCs) have made up an increasing portion of all loan originations in recent years.[40] As of the end of 2014, HELOCs make up over 15 percent of all loan originations, which is the highest percentage since 2008.

The one bright spot in the economic data may be that overall indebtedness is decreasing even as homeowners resume tapping their housing wealth for other needs. Both the percentage of households holding debt and the amount of that debt have decreased since the recession. The amount of income needed to pay down those debts has correspondingly declined as well. For households with debt, the median amount of annual income needed to service outstanding loans is down to about 16 percent.[41] This preference for less reliance on debt and greater financial stability may be reflected on a generational level as more Millennials decide to choose cash as their preferred investment vehicle instead of stocks,[42] and are relying less on credit cards.[43]

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[35] "Payday Lending in America: Who Borrows, Where They Borrow, and Why," (2012), Washington, D.C.: The Pew Charitable Trusts.

[36] Jesse Bricker et al., (2014), "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," Washington, D.C.: Board of Governors of the Federal Reserve System.

[37] "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012).

[38] Michael D. Shear and Jessica Silver-Greenberg, (2015), "Payday Loan Rules Proposed by Consumer Protection Agency," *The New York Times*, 26 March, 2015.

[39] Josh Zumbrun, (2014), "How to Save Like the Rich and the Upper Middle Class (Hint: It's Not With Your House)," *The Wall Street Journal*, 26 December 2014.

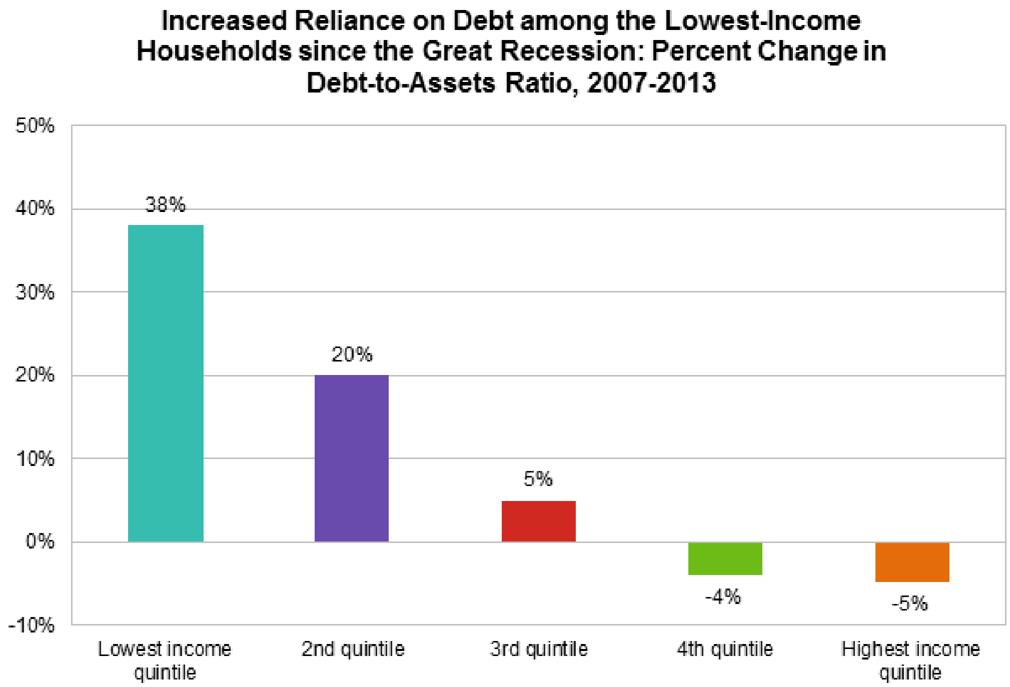
[40] "Home Equity Lines of Credit Jump 21 Percent through First Half of 2014 but Still 76 Percent Below 2006 Peak," (2014), *RealtyTrac*, 9 October 2014.

[41] "2013 Survey of Consumer Finances" (2013).

[42] Penelope Wang, (2014), "Millennials Are Hoarding Cash Because They're Smarter Than Their Parents," *Time*, July 21, 2014.

[43] "2013 Survey of Consumer Finances" (2013).

However, this decrease in debt has not caught up with the decline in assets. As noted above, net worth (the difference between assets and liabilities) has decreased since the Great Recession, and the debt-to-assets ratio has not significantly improved. In fact, the ratio between families' holdings of debt and their holdings of assets has worsened for households in the lowest three income quintiles since before the recession. The 38 percent increase in the debt-to-assets ratio for the lowest-income families, reaching a high of almost 19 percent, is particularly alarming.[44]



Source: "2013 Survey of Consumer Finances," (2013), Washington, D.C.: Board of Governors of the Federal Reserve System.

THE ROLE OF FLEXIBLE SAVINGS IN ECONOMIC MOBILITY

Being financially insecure in the short term not only endangers the near-term well-being of family members and ripples across the entire family financial balance sheet; it also has impacts across time, especially for families striving to move up the economic ladder. The path up and out of poverty is precarious if the rungs on the ladder are not secure. With each step up, a family risks falling back down if it doesn't have access to financial resources when emergencies arise. Building a personal financial safety net, accessible in the short term, is a prerequisite for improving financial outcomes over the long term. Research shows that the presence of liquid savings is strongly correlated with upward income mobility. Specifically, Americans born into the bottom income quintile and who successfully move up to a higher quintile have six times the median liquid savings as those who remain in the bottom quintile.[45]

[44] See chart, "Increased Reliance on Debt among the Lowest-Income Households since the Great Recession: Percent Change in Debt-to-Assets Ratio, 2007-2013."

[45] "Moving on Up: Why Do Some Americans Leave the Bottom of the Economic Ladder, but Not Others?" (2013), Washington, D.C.: The Pew Charitable Trusts.

These positive mobility effects of saving can further be bestowed on future generations. Children born into families with low incomes but relatively high-savings are significantly more likely to move up from the bottom of the income scale over their lifetime.[46] For children raised in the bottom 25% of families ranked by income, 71% of children with higher-saving parents moved up from the bottom over a generation; in contrast, 50% of children raised by lower-saving parents moved up from the bottom a generation later. [47] Having any kind of savings appears to make a difference rather than having a particular kind of savings.

Researchers do not fully understand all the mechanisms at play in the relationship between savings, financial security, and upward mobility. But it is logical that families can be thought of as progressing along the savings continuum from liquid savings, which act as a financial cushion, towards intermediate and long-term sustainable assets that promote intergenerational mobility. This financial cushion serves as a foundation that enables the accumulation of productive long-term investments, such as in education and home equity, which leads to greater rewards in the future. In addition to the financial benefits of saving, the experience of saving can change the way an individual projects their identity into the future and can foster positive attitudes, behaviors and choices, or "asset effects." These elements in turn support beneficial outcomes, including greater savings. From this perspective, having access to flexible savings is essential to getting started on the process that eventually leads to longer-term asset accumulation and upward mobility.

POLICY REFORMS TO SUPPORT FLEXIBLE SAVINGS AS A FOUNDATION FOR FINANCIAL SECURITY

Creating a policy landscape that supports flexible savings will require change on multiple fronts. Reorienting the entire savings policy infrastructure, which overemphasizes long-term savings at the expense of holistic financial stability, must be accomplished in a multistage process that builds from the bottom up. Only when the foundation is secure can the financial house stand tall.

While hundreds of billions of dollars are allocated by the federal government each year to support savings and asset development, no resources are specifically targeted at supporting the accumulation of flexible savings.[48] The result is fewer resources that can be accessed at discretion and without penalty, which ultimately destabilizes the foundation for longer-term asset accumulation. By supporting flexible savings, policymakers would not be compromising on the widely-shared policy goal of helping Americans build lifetime assets like retirement savings and home equity, but instead would be bolstering existing policy efforts by stabilizing a key foundation for financial security.

[46] Reid Cramer, Rourke O'Brien, Daniel Cooper, and Maria Luengo-Prado, (2009), "A Penny Saved Is Mobility Earned: Advancing Economic Mobility Through Savings," Washington, D.C.: The Pew Charitable Trusts.

[47] Ibid.

[48] See the tabulation of federal expenditures on asset accumulation in Rachel Black, (2014), "Rebalancing the Scales: The 2015 Assets Budget," Washington, D.C.: New America.

At the most basic level, in order for a financial foundation to be built, the barriers to saving must be removed—or, metaphorically speaking, the building permits for the financial house acquired. These financial barriers come in the form of asset limits in public assistance programs, which prevent families from building the pool of financial assets they need to keep from falling deeper into poverty at the first mishap.

No federal policies support the most foundational saving behavior: putting in place the kind of assets that provide for resilient financial houses that can weather the inevitable storms.

Once savings are allowed, families must have access to financial vehicles that allow them to accumulate assets. One can think of this as acquiring the necessary building materials for a house's structural foundation. In a financial sense, these include access to a savings account, checking account, or other means to perform necessary financial transactions on a daily basis, all while serving as a mechanism to store excess funds for the future and to begin earning interest and dividends.

Next, builders of financial houses must install the load-bearing structural supports that extend from the basement to the ceiling. Financially, these structural supports take the form of saving vehicles that are built for both long- and short-term uses, that is, for both the top and bottom of the financial house. Roth IRAs are a good example in that they permit short-term uses in an emergency, but also provide a favorable long-term asset. These assets extend from the financial foundation all the way to the heights of financial success, supporting the entire financial house along the way.

Finally, families require the economic incentive to build their financial house in a way that is both individually advantageous and socially beneficial. Metaphorically, a physical house provides a roof over family members' heads, but also provides the societal roots for a successful household that participates in the commonwealth and contributes to the social good. Metaphorically speaking, these socially beneficial economic incentives include all of the pro-homeownership policies in place, such as government-backed mortgages and the mortgage interest deduction that make homeownership possible for more Americans. In the financial sense, these supports take the form of policy incentives that promote savings. The government already provides over $500 billion in funds intended to be pro-saving, but the funds only incentivize the building of tall houses, not stable houses.[49] Taxpayers can take advantage of incentives for saving for retirement, even when they breach those accounts for short-term needs. No federal policies support the most foundational saving behavior: putting in place the kind of assets that provide for resilient financial houses that can weather the inevitable storms.

[49] Rachel Black, (2014), "Rebalancing the Scales: The 2015 Assets Budget," Washington, D.C.: New America.

These four stages of policy reform are described below along with discrete policy recommendations to achieve the reform.

Policy Goal	Policy Proposals
Remove Barriers to Saving	• Eliminate Asset Limits
Broaden Access to High-Value Financial Services	• Leverage Public Assistance to Promote Financial Inclusion • Implement Stronger Consumer Protections for Bank-Account Eligibility Screening • Expand Financial Services Through the U.S. Postal Service • Facilitate Access to Savings Vehicles at Tax Time
Leverage Long-Term Savings Mechanisms for Short-Term Needs	• Bring myRA to its Full Potential • Maximize the Reach and Impact of State-Based Retirement Savings Initiatives • Leverage Existing Private Sector Retirement Savings Plans
Establish Policy Incentives for Flexible Savings	• Create a Tax-Time Match for Savings Deposits

REMOVE BARRIERS TO SAVING

Many American families face significant barriers to beginning the process of building a small pool of financial resources. In addition to the challenges posed by simply earning low-incomes, struggling families are often hampered by legal prohibitions on possessing or accumulating savings. Asset limits in public assistance programs require families to divest themselves of most savings before accepting assistance and prevent families that are receiving support from building the foundational flexible savings they need to move up the economic ladder and eventually transition off of public assistance.[50] In some states, asset limits for the Supplemental Nutrition Assistance Program (SNAP) are as low as $2,000, and for Temporary Assistance for Needy Families (TANF) they can be as low as $1,000.[51] This means that for low-income families that rely on both TANF and SNAP to make ends meet, the effective asset limit is just $1,000, over which amount any money saved would make them ineligible for benefits. While 35 states and the District of Columbia have eliminated the asset test for SNAP, only 8 states have eliminated the TANF asset test. Since 81 percent of TANF beneficiaries also receive SNAP,[52] the effective asset limit for this group is usually the more restrictive TANF limit.[53]

Federal lawmakers have carved out a series of exemptions to asset tests. For example, tax-advantaged retirement savings accounts and college savings accounts are exempt from consideration in the SNAP program. However, limits on unrestricted savings prevent families with little or no saving experience from beginning the process of saving. These carve-outs may protect the assets of some families from "falling down the ladder," but families that have not yet begun to save are unlikely to consider investing in a 529 college savings account or 401(k) to be consistent with their current needs. A

[50] See Aleta Sprague and Rachel Black, (2012), "State Asset Limit Reforms and Implications for Federal Policy," Washington, D.C.: New America; Rachel Black, (2013), "Asset Limits in Public Assistance Programs: The Case for Reform," Washington, D.C.: New America; Rachel Black, (2013), "Asset Limits in the Supplemental Nutrition Assistance Program: The Case for Reform," Washington, D.C.: New America.

[51] "Asset Limits in Public Benefit Programs," (2015), Assets and Opportunity Scorecard, Washington, D.C.: CFED.

[52] Zedlewski, Sheila, (2012), "TANF and the Broader Safety Net," Washington, D.C.: Urban Institute.

[53] Virginia is the only state to have eliminated the TANF asset limit but not the SNAP asset limit: "Asset Limits in Public Benefit Programs," (2015), Assets and Opportunity Scorecard, Washington, D.C.: CFED.

study of "almost-participants" in Individual Development Account (IDA) programs, which assist low-income households in saving for specific, restricted purposes, found that those without a checking or savings account were more likely to drop out before the program started.[54] Similarly, participants who did participate in an IDA program were less likely to persist if they started without liquid assets.[55]

In addition to imposing an explicit barrier to the accumulation of savings, asset limits could also create a barrier to owning transaction and savings accounts. At least one previous study has found that bank account ownership, regardless of the balance of the account, has a significant negative association with participation in SNAP.[56] Likewise, a 2006 study with TANF participants in Maryland and Virginia found that some applicants feared that having a bank account would compromise their eligibility.[57] Similarly, in a study of eligible non-participants' perceptions of their SNAP eligibility, 73 percent of those who believed they did not qualify for the program had bank accounts, compared to only 62 percent of those who believed they were eligible.[58] This perception could be a consequence of the requirement that applicants provide detailed account information during the application process or a lack of understanding of the program eligibility rules. Regardless of the reason, this research suggests that some portion of applicants perceive that simply maintaining a bank account could jeopardize their access to needed benefits and thus lower rates of account ownership.

A broad-stroke elimination of asset limits across the board is the best solution to this patchwork of asset limits (which also includes asset tests in other public assistance program such as the Low Income Home Energy Assistance Program (LIHEAP) and Supplemental Security Income (SSI)) that stifles saving behavior. Incremental change through raising the asset limit by a few thousand dollars in certain states, piecemeal elimination state-by-state, or carve-outs for certain types of restricted savings accounts will not create the conditions for meaningful change. Simply having asset tests on the books has been shown to have a "chilling effect" on the saving behavior of public assistance beneficiaries who are concerned about the loss of benefits if they take the positive step of accumulating savings.[59] Critics may warn that asset-test elimination will lead to increased enrollment in public assistance programs, but

Eliminating asset tests is a necessary policy action in order to create the conditions for a culture of savings to take root.

[54] David W. Rothwell and Chang-Keun Han, (2009), "Second Thoughts: Who Almost Participates in an IDA Program?" St. Louis, MO: Center for Social Development, Washington University in St. Louis.

[55] Mark Schreiner and Michael Sherraden, (2005), "IDAs and Drop-out: Prediction and Prevention," *Financial Services Review 14*(1), 37-54.

[56] Jin Huang, Yunju Nam, and Nora Wikoff, (2010), "Household Assets and Food Stamp Program Participation among Eligible Low-income Households," St. Louis, MO: Center for Social Development, Washington University in St. Louis.

[57] Rourke O'Brien, (2006), "Ineligible to Save? Asset Limits and the Savings Behavior of Welfare Recipients," Washington, D.C.: New America Foundation.

[58] Economic Research Service, (2004), "Food Stamp Access Study," Washington, D.C.: United States Department of Agriculture.

[59] Aleta Sprague and Rachel Black, (2012), "State Asset Limit Reforms and Implications for Federal Policy," Washington, D.C.: New America.

the available evidence contradicts that assertion.[60] Eliminating asset tests is a necessary policy action in order to create the conditions for a culture of savings to take root.

BROADEN ACCESS TO HIGH-VALUE FINANCIAL SERVICES

A prerequisite for building a financial house is having access to the appropriate materials. In the case of a financial house, the basic building block is a safe, low-cost place to keep money, make payments, and build savings. Everyone needs a safe and low-cost place to manage their money. Simply having access to a savings account is correlated with higher rates of saving. Individuals with a savings account save about three times as much of their income as those without an account (9 percent of income compared to 3 percent).[61]

Millions of Americans, however, are without even these basic building blocks. According to the FDIC, about one in ten Americans lacks a checking account and three in ten lack a savings account.[62] For households with incomes under $15,000, a full 28.2 percent are unbanked and an additional 21.6 percent are underbanked. Over 70 percent of all unbanked households in the U.S. make less than $30,000 a year. There are many reasons why lower-income families may choose not to maintain bank accounts, including account and overdraft fees, minimum balance requirements, a general lack of money to keep in an account, and, as noted above, deterrents embedded in public assistance programs.[63]

Due to these and other barriers to traditional checking and savings accounts, non-traditional financial products provide options for millions of Americans who lack access to these accounts. To protect consumers who use these alternative options, the CFPB has proposed a set of regulations to provide increased structure to the marketplace of prepaid- and payroll-card offerings. Regardless of the provider, however, creating access to a safe, functional, low-cost account for all Americans should be a policy priority.

LEVERAGE PUBLIC ASSISTANCE TO PROMOTE FINANCIAL INCLUSION

Millions of Americans temporarily utilize public assistance programs for financial and nutritional support. The past twenty years have seen a transformation in the way benefits are delivered across these and other government programs, including TANF, SNAP, Unemployment Insurance, and Social Security, as electronic and card-based methods have generally replaced paper checks. Corresponding changes in the banking market create the opportunity for public assistance programs to make financial inclusion an auxiliary benefit of government-provided assistance. Rather than assigning an Electronic Payment Card (EPC) or Electronic Benefits Transfer (EBT) card that has limited function and ceases to be useful upon transitioning off of assistance, states and the federal government should prioritize delivery of benefits to bank accounts where possible, and assistance for the unbanked should be delivered in ways that support inclusion in the financial system with a safe, functional, low-cost account that is either card-based or connected to a

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[60] Leah Hamilton , Ben Alexander-Eitzman , Whitney Royal, (2015), "Shelter From the Storm: TANF, Assets, and the Great Recession," *SAGE Open*.

[61] "Report on the Economic Well-Being of U.S. Households in 2013," (2014), Washington, D.C.: Board of Governors of the Federal Reserve System, 17.

[62] "2013 National Survey of Unbanked and Underbanked Households," (2014), Federal Deposit Insurance Corporation.

[63] See Pamela Chan, (2011), "Beyond Barriers: Designing Attractive Savings Accounts for Lower-Income Consumers," Washington, D.C.: New America Foundation; and Rourke O'Brien, (2012), "We Don't Do Banks," Washington, D.C.: New America Foundation.

conveniently located financial institution. States should establish direct deposit as a default mechanism for benefit delivery and negotiate EBT/EPC contracts that prioritize the needs of consumers with an emphasis on low-fees and high functionality. The federal government could prioritize financial inclusion by providing best practices for EBT/EPC contracts; extending Regulation E of the Electronic Fund Transfer Act to all cards delivering TANF funds; and ensuring the continued viability of bank accounts for TANF recipients.[64]

IMPLEMENT STRONGER CONSUMER PROTECTIONS FOR BANK-ACCOUNT ELIGIBILITY SCREENING

The most common reason that checking account applications are denied is because of a negative screening hit when banks run queries of consumers' banking history.[65] These screens are run using consumer reporting services for bank accounts such as ChexSystems and Early Warning, which function similar to services that perform credit checks. A quarter of all banks report automatically rejecting a checking-account applicant who presents adverse information during the screening process.[66] By one estimate, more than a million low-income Americans are categorically excluded from the mainstream banking system because of these reports.[67] In response to concerns about "imperfections and inconsistencies" in the consumer data that is reported to and used by banks in screening checking account applicants, the CFPB is scrutinizing the reporting practices.[68] Action along this front is already underway in the state of New York, which is working with major financial service providers to remove barriers to bank accounts imposed by ChexSystems. New York City's Department of Consumer Affairs estimates that this and similar databases have prevented more than 825,000 residents in New York City alone from opening an account, often as a result of isolated mistakes, like overdrafts, rather than the kinds of fraudulent activities the system was intended to detect. More work remains to be done legislatively and through regulations to ensure that consumers are not unfairly excluded from the banking system because of minor errors in the past.

EXPAND FINANCIAL SERVICES THROUGH THE U.S. POSTAL SERVICE

Beyond greater consumer protections, many proposals to expand access to appropriate financial products for low-income consumers have involved innovative uses of modern technology platforms to manage funds. Allowing consumers to conduct necessary financial transactions like paying bills, depositing paychecks, and saving for emergencies without a brick-and-mortar bank—and instead through high-quality, well-regulated prepaid card products—could have the potential to broaden financial capability. However, challenges remain for these products in terms of accepting cash deposits and providing access to savings accounts.

Last year, the U.S. Postal Service Inspector General (IG) offered an innovative proposal to marry the modern technology for account management and transactions to the United States Postal Service's (USPS) country-wide presence in American

[64] Aleta Sprague, (forthcoming), "Leveraging Public Assistance to Promote Financial Inclusion: A New Approach for TANF," Washington, D.C.: New America.

[65] "2011 Survey of Banks' Efforts to Serve the Unbanked and Underbanked," (2012), Federal Deposit Insurance Corporation.

[66] Ibid., Appendix A.

[67] Jessica Silver-Greenberg, (2013), "Over a Million Are Denied Bank Accounts for Past Errors," *The New York Times*, 30 July 2013.

[68] Ann Carrns, (2014), "Bank Clients Might Be Unfairly Denied Accounts," *The New York Times*, 10 October 2014.

communities by reviving the USPS's dormant banking and financial operations.[69] During the first half of the twentieth century, the USPS ran the Postal Savings System, which accepted savings deposits from consumers.[70] Seeking to create a twenty-first century version of these services, the Inspector General included in his proposal the idea to offer reloadable prepaid cards specifically targeted at the un- and underbanked. This proposal should be explored by policymakers with a focus on providing savings options that are generally not present in the existing prepaid card market. Such a feature would allow customers to deposit cash at a USPS location or use payroll deduction to create an emergency savings cushion. If implemented, this proposal could improve the options for flexible savings products available to low-income Americans, have a positive impact on their financial security, and improve the utility and viability of the USPS's suite of financial offerings.[71]

FACILITATE ACCESS TO SAVINGS VEHICLES AT TAX TIME

In recent years, significant effort has been expended to promote saving at tax time. Many striving families see their largest infusion of annual resources through their tax refund, which creates natural opportunities to accumulate savings. The federal tax refund system allows refunds to be split into as many as three different accounts (to accommodate deposits into checking and savings accounts) and currently allows for the purchase of savings bonds on the tax form.[72] Financial inclusion and savings goals could be furthered by creating access points for more savings products at tax time. The Asset Building Program previously proposed allowing refunds to be delivered to unbanked and underbanked tax filers via prepaid cards that included a savings function.[73] This idea was piloted by the Treasury Department, and in spite of significant implementation issues, was found to offer promise to tax filers and to the Treasury Department.[74]

Efforts to promote the adoption of savings products at tax time need not be restricted solely to prepaid cards. The Financial Security Credit Act of 2013 was a legislative proposal that included a mechanism to allow taxpayers to open certain accounts, including savings accounts and certificates of deposit (CDs), directly on the tax form.[75]

Two large-scale and rigorously evaluated pilots designed to test the viability of tax-time savings promotions demonstrate the demand for access to basic financial products during the tax-filing process and the potential for this approach at scale. SaveUSA, a four-city demonstration project, offered a suite of behavioral and institutional interventions, including facilitated account opening through VITA sites. Refund to Savings (R2S), an initiative of the Center for Social Development at the University of Washington in St. Louis, Duke University, and TurboTax, the developer Intuit, sought to

[69] "Providing Non-Bank Financial Services for the Underserved," (2014), White Paper, Office of Inspector General, United States Postal Service.

[70] "Postal Savings System," (2008), United States Postal Service Historian, July 2008.

[71] Paul Waldman, (2014), "Could Postal Banking Be the Next Big Thing?" *The American Prospect*, 4 February, 2014; David Dayen, (2014), "The Post Office Should Just Become a Bank: How Obama Can Save USPS and Ding Check-Cashing Joints," *New Republic*, 28 January, 2014.

[72] "Keep Bonds Easy: Preserving Universal Access through Advocacy, Awareness, and Action," (2012), Allston, MA: Doorways to Dreams Fund (D2D).

[73] Melissa Koide, (2008), "SAFE-T Accounts: A Proposal to Deliver a Low Cost, High Value Transaction and Savings Account at Tax Time," Washington, D.C.: New America.

[74] Caroline Ratcliffe and Signe-Mary McKernan, (2012), "Tax Time Account Direct Mail Pilot Evaluation," Washington, D.C.: Urban Institute.

[75] Reid Cramer and Elliot Schreur, (2013), "A Citizen's Guide to the Financial Security Credit," Washington, D.C.: New America.

test a comparatively modest approach: build simple nudges into the tax filing process to encourage low-income households to direct a portion of their refund into a preexisting savings account.

In the case of SaveUSA, two-thirds of all of the participants assigned to the treatment group successfully deposited and held savings for the full year and received the match. In comparison, few low-income tax filers in the control chose to save any of their refund. At the two sites where this randomized assignment took place, New York and Tulsa, respectively only 9 percent and 23 percent of control-group participants directly deposited any of their refund, compared to 90 percent of the SaveUSA group. Importantly, about 30 percent of the SaveUSA participants in New York were unbanked, so tax filing offered a point of access to a savings vehicle and facilitated the decision to save.[76]

It is instructive to compare these outcomes with the R2S design where participants were restricted to preexisting accounts. In this study, 39 percent of participants identified a preference for receiving their refund in a method other than the option they selected. Fully half of the unbanked respondents would have chosen a new checking or savings account, had the option been available to them.[77] Including the option to open an account at this time could have increased the choice to save among the participants who lacked a convenient or attractive way to save, as it did in SaveUSA.

LEVERAGE LONG-TERM SAVINGS MECHANISMS FOR SHORT-TERM NEEDS

Current tax policy heavily supports the accumulation of restricted savings, such as retirement savings, with no supports in place for flexible savings. This approach leads Americans to build their financial house without a foundation, an important consequence of which is lower overall financial security. Proposals to promote retirement security often include a recommendation to increase the penalties for early withdrawals or to create systems that allow for no withdrawals at all. These proposals miss the fundamental crux of the problem. Policy should not pit an individual's savings needs against one another. Instead, policy should embrace the multitude of savings needs and encourage the adoption of systems that meet the diversity of those financial needs. Products based on Roth IRAs have the flexibility to serve as both short- and long-term savings vehicles because of the post-tax nature of the accounts, which allows taxpayers to withdraw for any purpose the funds contributed to the account. Only investment or interest earnings on those funds are restricted to retirement purposes, and even certain amounts of earnings can be withdrawn under certain circumstances. Traditional IRAs or 401(k)s, on the other hand, receive contributions pre-tax and impose taxes and penalties if any funds are withdrawn for non-retirement uses (with certain exceptions). For this reason, Roth IRAs can serve the dual purpose of being a source of flexible savings in the short term and also an "on-ramp" to longer-term retirement savings. These features of Roth IRAs should be considered and embraced by policymakers attempting to broaden access to the retirement savings system. In addition, existing restricted savings products, like Traditional IRAs or 401(k)s, should be reformed to recognize the extent to which flexible savings are necessary to the development of retirement savings.

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[76] Gilda Azurdia, Stephen Freedman, Gayle Hamilton, and Caroline Schultz, (2013), "Encouraging Savings for Low- and Moderate-Income Individuals: Preliminary Implementation Findings from the SaveUSA Evaluation," New York: MDRC.

[77] Michal Grinstein-Weiss et al., (2014), "Refund to Savings: 2013 Evidence of Tax-Time Saving in a National Randomized Control Trial," CSD Research Report 14-03, St. Louis, MO: Washington University, Center for Social Development.

BRING MYRA TO ITS FULL POTENTIAL

The flexibility of the Roth IRA structure is on display in the myRA, or "my Retirement Account," proposed by President Obama in 2014 and currently being implemented by the Treasury Department.[78] MyRA creates a Roth IRA-based savings product for employees of employers that do not offer a retirement savings plan but that volunteer to connect the employee to the account via payroll deduction. MyRAs have all the features of a Roth IRA that make them attractive as flexible-use accounts, such as post-tax contributions and tax-free earnings, and also have a number of other advantages that make them particularly attractive to the low- and middle-income families that need help building both flexible and long-term savings. Funds in a myRA are invested in safe, no-cost U.S. Treasury Bonds with the same yield as the G Fund of the Thrift Savings Plan offered to federal government employees. The earnings on the funds are low, but the purpose of the program is not to be a solution for retirement insecurity. Rather, it is to serve as a tool to help workers begin to save and build assets. To this end, funds in a myRA will be rolled over into private-market Roth IRA once the account balance reaches the account cap of $15,000. MyRAs can be opened with an initial investment of just $25 and have no minimum contribution requirement, making these a feasible option for low-income workers to save for the long term.

Most importantly for efforts to build flexible savings, however, is the fact that any contributed funds to myRAs may be withdrawn to meet immediate needs. This assurance that funds will be there when needed could help to address the low take-up rate of retirement plans among low-income workers. Less than four in ten employees in the lowest decile of earnings choose to participate in a workplace retirement plan when they are offered one (only 27 percent are even offered one), compared to about nine out of ten employees in the highest decile.[79] Knowing that their savings will be there for them could be an important factor in these workers' future decisions to save for the long-term. Saving for retirement has long been the biggest saving priority for many families. For a decade up until the Great Recession in 2008, saving for retirement was the most common response households gave to a survey conducted by the Federal Reserve. After the recession, liquidity overtook retirement as the most common response with retirement a close second.[80] Given that saving for retirement and flexible savings together account for two thirds of all households' responses to a survey question about the most important reason for saving, the myRA, which serves both of these needs, is well-positioned to serve consumers in this area.

However, in order to ensure that myRAs can reach their potential to meet the unmet need for appropriate flexible financial products, certain changes are needed. The accounts should be made as universally accessible as possible, meaning facilitating account opening at tax time, ensuring that all workers with earned income are eligible to participate, and encouraging all employers that do not sponsor a retirement account to offer payroll deposit myRAs to their employees. Congress should study ways to amend existing retirement-security law to permit auto-enrollment and auto-escalation of contributions into the accounts and should make permanent the myRA so that it is available to future generations. Finally, the Treasury Department should work to emphasize the flexibility inherent in the accounts in order

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[78] See Reid Cramer, Justin King, Elliot Schreur, and Aleta Sprague, (2014), "Solving the Retirement Puzzle: The Potential of myRAs to Build a Personal Safety Net," Washington, D.C.: New America.

[79] "Retirement benefits: Access, participation, and take-up rates,1 private industry workers," (2014), National Compensation Survey, Bureau of Labor Statistics, March 2014.

[80] 2013 Survey of Consumer Finances" (2013).

to increase take-up of the accounts among populations that are weary of having their funds inaccessible in times of financial distress.[81]

MAXIMIZE THE REACH AND IMPACT OF STATE-BASED RETIREMENT SAVINGS INITIATIVES

Widespread awareness of and concern about the national deficit of retirement savings has led approximately 20 states to advance legislation or study their own plan to provide access to retirement savings accounts for those without an employer-based plan.[82] California and Illinois have both passed legislation to create so-called "Secure Choice" retirement savings plans. While California is in an extended period of study,[83] Illinois is moving directly to plan implementation.[84] Although this state action on retirement security occurs largely as a matter of necessity in response to legislative inaction at the federal level, this new trend towards retirement security federalism has the potential to increase overall financial security through flexible savings at the same time as it improves residents' prospects for retirement security. This is because Secure Choice proposals, like the one successfully passed by Illinois, may be based upon Roth IRA accounts, much like the myRA at the federal level. Secure Choice could potentially build the short- and long-term financial security of millions of American workers by vastly expanding the ownership of Roth IRAs. Just 15.6 percent of Americans currently own such an account, and only 6 percent of Americans earning below $50,000, roughly the national median income, do so.[85]

The impact of Secure Choice-type plans remains unproven. Skeptics have argued that the plan will not prove to offer real retirement security, due in part to the flexible nature of Roth IRAs. Others have argued that Secure Choice-type plans might be detrimental to the near-term well-being of struggling workers, who will be surprised by the automatic enrollment and default contribution levels. Given the extent to which Americans currently lack both flexible savings and retirement savings, this plan represents a significant improvement over the status quo. However, policymakers should seize the opportunity to structure Secure Choice-type plans in ways that explicitly work to build the financial security of low-income workers and attempt to preserve assets for retirement. New America has previously written about a pilot program called AutoSave, through which employers automatically divert a small portion of workers' post-tax earnings into a flexible -use savings account. This initiative provides an example of how the same payroll deduction process can facilitate a non-retirement "sidecar" savings account with few if any restrictions on withdrawals.[86] Policymakers should design and implement an AutoSave function for emergency savings as a supplement to Secure Choice initiatives. Secure Choice plans typically call for a default contribution of 3 percent of income into the retirement account. A 1 percent

[81] These policy proposals are detailed in Reid Cramer, Justin King, Elliot Schreur, and Aleta Sprague, (2014), "Solving the Retirement Puzzle: The Potential of myRAs to Build a Personal Safety Net," Washington, D.C.: New America.

[82] "Will 2015 Be the Year for State Sponsored Retirement Savings Plans?" (2015), Georgetown university Center for Retirement Initiatives.

[83] See Aleta Sprague, (2013), "The California Secure Choice Retirement Savings Program: An Innovative Response to the Coming Retirement Security Crisis," Washington, D.C.: New America.

[84] See Elliot Schreur, (2015), "Retirement Security Federalism in Action: An Analysis of the Illinois Secure Choice Savings Program," Washington, D.C.: New America.

[85] Sarah Holden and Daniel Schrass, (2015), "Appendix: Additional Data on IRA Ownership in 2014," *ICI Research Perspective 21* (1A).

[86] Alejandra Lopez-Fernandini and Caroline Schultz, (2010), "Automating Savings in the Workplace: Insights from the AutoSave Pilot," Washington, DC: New America Foundation.

AutoSave "sidecar" savings account could effectively maximize the potential of Secure Choice to promote sufficient accumulations of flexible savings and retirement savings.[87]

LEVERAGE EXISTING PRIVATE SECTOR RETIREMENT SAVINGS PLANS

Existing data about withdrawals or "leakage" from retirement plans strongly support the notion that a lack of emergency savings impacts not just Americans without access to employer-based retirement plans, but even those who do participate. Indeed, given the size of the population that lacks an emergency savings account, it is quite conceivable that there are a sizeable number of Americans that have an employer-sponsored retirement savings account but do not have an emergency savings account. That outcome would indeed be natural in a world where retirement accounts are sponsored by employers, automatic enrollment for retirement accounts is allowed, and employer matches and tax incentives are offered for retirement plans, and none of those features are present for emergency savings accounts. "Sidecar" flexible savings accounts therefore should not be solely a consideration for those with access to a Secure Choice-type plan, but also for workers who have an employer-sponsored retirement savings account. Precedent for this arrangement can be found overseas. In the United Kingdom, "corporate platform" accounts "allo[w] employees to use the employer's retirement savings mechanism to save and invest for additional non-retirement purposes."[88] Allowing and encouraging similar arrangements in the United States would support increased financial security, could reduce penalized withdrawals from existing plans, and support a more stable financial framework for approximately half of the American workforce.

ESTABLISH POLICY INCENTIVES FOR FLEXIBLE SAVINGS

Historically, the vast majority (over 90 percent) of federal funding spent on asset-building policy has been delivered through the tax code.[89] Hundreds of billions of dollars are allocated to support assets like retirement savings and home equity, but no funds go to helping Americans build flexible savings. Tax reform offers a promising opportunity to build on this asset-building policy structure embedded in the tax code to create meaningful flexible savings supports.

> Tax reform offers a promising opportunity to build on the asset-building policy structure embedded in the tax code.

The Earned Income Tax Credit (EITC) creates a meaningful opportunity for striving Americans to save and build wealth. Yet savings remains a challenge for low- and moderate-income Americans at tax time. A survey of EITC recipients found that most plan to use their refund to pay off debt, which can be an important precursor to greater savings.[90] Research on EITC expenditures also shows that many EITC recipients use the funds for durable transportation

[87] Michael Calabrese, Reid Cramer, and Aleta Sprague, (2013), "Designing California's Secure Choice Savings Program: Policy Considerations for Building an Automatic and State-Based Savings Platform," Washington, D.C.: New America.

[88] David C. John, (2012), "Improving All Types of Saving With the UK's Expanded Retirement Savings Platform," Washington, DC: Brookings Retirement Security Project.

[89] Reid Cramer, Rachel Black, and Justin King, (2012), "The Assets Report 2012: An Assessment of the Federal "Asset-Building" Budget," Washington, D.C.: New America; Rachel Black, (2014), "Rebalancing the Scales: The 2015 Assets Budget," Washington, D.C.: New America.

[90] Mary Linnenbrink et al., (2008), "The Earned Income Tax Credit: Experiences from and Implications of the Voluntary Income Tax Assistance Program in Georgia," *Journal of Extension 46*(1).

expenses to get to work, meaning cars in most instances.[91]. While families may be able to put off some expenses until February or March when most EITC refunds are issued, this strategy does not help with unpredictable, year round needs. The financial need faced by the majority of financially insecure Americans is for a pool of year-round unrestricted savings.

Only about 10 percent of EITC recipients report planning to save most of their refund for an emergency, as this behavior is not incentivized by policy in the same way that saving for retirement or in home equity is.[92] In the case of long-term savings, the benefits of public policy accrue to those with the highest incomes, who can take advantage of non-refundable tax preferences. Low-income taxpayers, who need the most help saving for the future, benefit little from these tax provisions to support long-term savings and receive no support to save for short-term uses. Policy must shift to support flexible savings for those who need the most help. Research shows that when presented with appropriately targeted incentives, low-income taxpayers overwhelmingly choose to save their refund for the future.[93]

CREATE A TAX-TIME MATCH FOR SAVINGS DEPOSITS

One policy proposal to address this need is to create a Financial Security Credit.[94] The Financial Security Credit is a proposed refundable tax credit that would offer a real financial incentive to low-income families to save for all purposes, including emergencies. The tax provision would be built on top of existing supports for saving such as 401(k)s and IRAs, but would deliver real benefits to families left out of the current system at a fraction of the cost of these existing saving supports.[95] The credit would function as a matching deposit of up to $500 a year on funds saved by individuals. Unlike current policy, the matching funds would be directly deposited into the recipient's savings vehicle, rather than being delivered as part of a refund, and the credit could support saving in a range of vehicles including retirement accounts, 529s, and short-term savings vehicles like savings accounts.

Outcomes of SaveUSA suggest that both the choice to save and amount to save can be motivated by the presence of a match. In a survey of participants in $aveNYC (a precursor to SaveUSA), the availability of a match was listed as the "most important reason" for opening an account. The presence of a meaningful incentive, in the form of a direct match, made saving valuable for households with tight financial margins.[96]

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[91] Andrew Goodman-Bacon and Leslie McGranahan, (2008), "How do EITC recipients spend their refunds?" *Federal Reserve Bank of Chicago Economic Perspectives* 2Q/2008.

[92] Mary Linnenbrink et al., (2008), "The Earned Income Tax Credit: Experiences from and Implications of the Voluntary Income Tax Assistance Program in Georgia," *Journal of Extension 46*(1).

[93] For an overview of the existing research, see Rachel Black and Elliot Schreur, (2014), "Connecting Tax Time to Financial Security: Designing Public Policy with Evidence from the Field," Washington, D.C.: New America. For a specific experimental case, see Gilda Azurdia, Stephen Freedman, Gayle Hamilton, and Caroline Schultz, (2013), "Encouraging Savings for Low- and Moderate-income Individuals: Preliminary Implementation Findings from the SaveUSA Evaluation." New York: MDRC.

[94] Reid Cramer and Elliot Schreur, (2013), "A Citizen's Guide to the Financial Security Credit," Washington, D.C.: New America.

[95] "The Financial Security Credit: Tax Reform that Supports Savings for Hard-Working Americans." 2012. Washington, D.C.: New America.

[96] Center for Community Capital, (2013), "The Importance of Tax Time for Building Emergency Savings: Major Findings from $aveNYC," Chapel Hill, NC: Center for Community Capital.

Other aspects of the match design also proved significant in determining the amount to save. In all three years of $aveNYC, about half of participants saved up to the match. A doubling of the match limit from $500 in 2008 and 2009 to $1,000 in 2010 resulted in an increase in average savings from $380 to $700, without a decline in participation. It is important to note that at the same time the average refund amount increased from $3,303 to $4,155 as a result of the EITC and Child Tax Credit expansion passed in the American Recovery and Reinvestment Act, and, as previously discussed, the size of the initial deposit is linked to the size of a participant's refund. While the effects of each variable could not be distinguished from each other, the observation that the match limit is treated as a savings target is consistent with other matched savings experiences. [97]

From the perspective of the government, the economic effect of the credit is the same as tax-deferred 401(k)s: financial support is provided as a percentage of the assets saved. In the case of tax-deferred retirement accounts, taxpayers see the benefit in the form of untaxed income that increases with their tax bracket. Under the Financial Security Credit, eligible participants would see the benefit in the form of a refundable tax credit equal to a percentage of the amount saved. The difference is in the individual's experience of the saving support, and in this case the refundable credit offered by the Financial Security Credit is far superior for the low- and middle-income taxpayers who get little to no benefit from existing saving supports. Policy should support the building of flexible savings through better-designed and better-targeted incentives for the full range of savings needs.

CONCLUSION

Using policy levers to support flexible savings in addition to other kinds of assets is not a zero-sum game. Far from sacrificing long-term asset building in favor of the short term, implementing policy supports to help Americans build flexible savings improves prospects for long-term asset development and economic mobility by bolstering short-term financial security. In an age of income fluctuations and unpredictable expenses, especially for low-income families, having flexible resources at hand to deploy in times of income dips, or when unexpected expenses arise, can be the difference between upward economic mobility and perpetually just treading water.

Policy options at the federal level to support flexible savings include reforming tax incentives for saving to specifically target flexible savings, expanding consumer protections for and access to basic savings vehicles, and eliminating asset tests in public assistance programs. At the state level, policymakers should make the conscious policy choice to include flexible features in universal retirement savings programs. Taking policy action to support flexible savings would have wide-ranging effects on Americans' financial security in the short term. These effects would in turn translate into the kind of sustainable long-term asset development necessary for achieving lasting economic mobility for more American families.

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[97] See Michael Sherraden, Mark Schreiner, and Sondra Beverly, (2003), "Income, Institutions, and Saving Performance in Individual Development Accounts," *Economic Development Quarterly* 17(1): 95-112; and Sonia Sodha and Ruth Lister, (2006), "The Saving Gateway: From Principles to Practice," London: IPPR.

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DC OFFICE

1899 L Street, NW, Suite 400
Washington, DC 20036
www.NewAmerica.org
T: 202-986-2700
F: 202-986-369