



Emergency Savings Accounts May Change Mindset and Retirement Outcomes

Through SECURE Act 2.0 (SECURE 2.0), lawmakers are hoping to expand retirement plan coverage, increase retirement savings, preserve retirement income, and simplify and clarify retirement plan rules to help address the retirement savings crisis many US workers are facing.

In a nutshell, they want to make it easier for businesses to establish and maintain more retirement plans so employees can save more for retirement. It, therefore, seems perplexing and counterproductive to the stated goals that the law creates several new or expanded options to take money out of retirement plans early without penalty. One new SECURE 2.0 account saving/withdrawal option, however, may actually help to begin reversing the retirement savings shortfall by changing participants' mindsets and behaviors toward early withdrawals.

Our Retirement Savings Crisis

For years, studies have been substantiating a retirement savings crisis among US workers. The retirement savings shortfall is estimated at \$3.68 trillion.¹ Statistically,

- 51 percent of consumers between 45 and 75 feel they do not have enough retirement savings to last their lifetime;
- 32 percent are not confident they will have enough money in retirement to cover basic monthly expenses; and
- 44 percent of retirees have gone back to work to ensure adequate retirement income.²

Workplace retirement plans are the leading venue for accumulating assets for retirement. But as mentioned earlier, low levels of access and savings rates were the impetus for SECURE 2.0.

1. Employee Benefits Research Institute

2. [Alliance for Lifetime Income, Protected Retirement Income and Planning, 2023](#)

Our Emergency Savings Crisis

We must start further upstream to really understand the retirement savings crisis. The [personal savings rate](#) in the U.S. has fallen to 3.9 percent. For a comparison, the rate was 32 percent in April of 2020. Nearly a quarter of consumers (24 percent) have no savings set aside for emergencies, while 39 percent have less than a month of income saved for urgent needs.³ Furthermore, for those with no emergency savings, most (59 percent) withdrew money from their retirement accounts if they had one at some point in the past 12 months to help them get by.⁴ 401(k) plan recordkeepers also noted an uptick in hardship distributions in the last year.⁵

Leakage reduces retirement savings

Early access to retirement plan assets is one of three identified plan leakages, with cash outs at job change and plan loan repayment failures as the other two. Plan leakage as a whole is estimated to reduce age-60 retirement plan balances by 25 percent,⁶ slashing the average 401(k) plan account balance for a participant in his/her 60s from \$350,000 to \$262,500.⁷ Another survey concluded that plan participants with at least one hardship withdrawal increase their retirement savings deficit by 36 percent.⁸

More early withdrawal options

Under SECURE Act 2.0, plan sponsors can add, or make more liberal, early distribution options for

- Emergencies
- Firefighters
- Domestic abuse victims
- Those who are terminally ill
- Long-service public safety employees
- Qualified federal disasters and
- Long-term care insurance.

While leakage is detrimental to asset accumulation, at the same time, studies have found that allowing plan participants access to their money when they need it actually encourages greater participation and larger contributions.⁹

These are in addition to a long list of established early distribution triggers that increase the potential for retirement savings leakage. While leakage is detrimental to asset accumulation, at the same time, studies have found that allowing plan participants access to their money when they need it actually encourages greater participation and larger contributions.⁹ Finding the balance between the two competing needs has proven difficult.

3. [Consumer Financial Protection Bureau, Emergency Savings and Financial Security, 2022](#)

4. Ibid, p.36

5. [White, Martha C., "Its More Expensive to Live and Workers are Tapping 401\(k\)s to Live," New York Times, May 29, 2023](#)

6. [Munnell, Alice H., 2022, January 3, "Study on Leakages Narrows the Range of Estimates," Center for Retirement Research at Boston College](#)

7. [ICI Research Perspective, Vol. 28, No. 11, November 2022](#)

8. [Employee Benefit Research Institutes, Workplace Account Leakage by the Numbers, 2022](#)

9. [Munnell, Alice H., 2022, January 3, "Study on Leakages Narrows the Range of Estimates," Center for Retirement Research at Boston College](#)

New account option may change mindset and outcomes

SECURE 2.0 may have delivered the beginnings of a happy medium between excessive plan leakage and necessary access to assets in the form of Emergency Savings Accounts (ESAs). This is a new type of account that businesses can add to their workplace retirement plans where saved assets are earmarked specifically for emergency purposes. Participants who need it most can actively and intentionally use their retirement plans to save for a rainy day.

Effective for the 2024 and later plan years, employers may offer nonhighly compensated employees (nonHCEs) ESAs in individual account plans like 401(k), 403(b) and governmental 457(b) plans under the following structure.¹⁰

- **Optional automatic enrollment.** At the employer's discretion, automatic enrollment can apply with deferrals beginning at 3% and capped at \$2,500 (or a lower amount at the employer's discretion). The \$2,500 cap is attributable to participant contributions and will be indexed for inflation. No minimum contribution or balance requirements may apply. The law pre-empts state anti-garnishment laws as well.
- **Contributions are Roth-like.** Emergency savings account contributions are made on a Roth (after-tax) basis and credited to the separate ESA within the plan. They count toward a participant's overall annual deferral limit and annual additions limit. Further, unless future guidance excludes them, they would be included in the actual deferral percentage (ADP) test for the plan as a whole.
- **Employer matching contributions are possible.** Contributions are treated as elective deferrals for matching contribution purposes if the plan provides a match. The match is capped at \$2,500 (or a lower amount at the employer's discretion). Matching contributions are credited to the participant's matching account within the plan.
- **Additional contributions are possible.** Contributions above the cap can be directed to the plan's designed Roth account or stopped until the ESA balance drops below the limit.
- **Withdrawals are liberal.** Participants must be allowed to take at least one withdrawal per month, and the first four withdrawals per year may not be subject to any plan fees or charges. ESA distributions are not subject to the 10 percent early withdrawal penalty tax.
- **Account investments are conservative.** ESAs may be invested in cash, interest bearing deposit accounts, or principal preservation accounts designed to maintain the dollar value invested, preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with the need for liquidity; and offered by a State- or federally-regulated financial institution.
- **Amounts are rollable.** At separation from service, employees may take their emergency savings accounts as cash or roll them to their designated Roth accounts or IRAs
- **No penalty for highly compensated employees.** A nonHCE who is enrolled in an ESA and later becomes a highly compensated employee (HCE) may not make further contributions, but retains the right to withdraw any accumulated account balance.

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10. SECURE Act 2.0, Section 127 amends Subtitle B of title I of the Employee Retirement Income Security Act of 1974 by adding at the end the following: "PART 8—PENSION-LINKED EMERGENCY SAVINGS ACCOUNTS"

ESAs are garnering a lot of attention among plan sponsors as well as employees, and the initial reaction is very favorable. When surveyed, 73 percent overall and 88 percent of Millennial participants intend to contribute additional money to their 401(k)s to take advantage of ESAs once they are incorporated into their plans. Further, overall, 54 percent of nonparticipants and 77 percent of Millennial nonparticipants say they intend to begin plan participation once ESAs become available.¹¹

The decision to allow plan participants greater ability to take money out of their retirement accounts early rests with plan sponsors. SECURE 2.0 offers numerous options, each of which must be judged according to the best interest fiduciary standard: Is this in the best interest of plan participants?

Conclusion

Some may say an ESA is a bit of a mind game. Overall, they do not allow a participant to save more (as an overall dollar amount annually) in a plan than the maximum prescribed limits. But the idea of a specific account within a retirement plan that is earmarked for emergencies could encourage a plan participant to save more than he or she otherwise would. They may also be the enticement needed to get nonparticipants to begin saving.

11. [2023 Natixis Defined Contribution Plan Survey](#)

SECURE 2.0 Act is broad legislation designed to help Americans save for their future through provisions that aim to expand access to retirement plans, increase savings opportunities for employees and streamline administration of employer-sponsored retirement plans, including 401k plans.

An **emergency savings account (ESA)** is an employer-sponsored account that helps workers save for financial emergencies by automatically deducting an amount from each paycheck and depositing it into a separate account.

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