Emergency savings account within a qualified retirement plan

65% of Americans save little or nothing.[1]

40% would not be able to cover a $400 unexpected expense.[2]

An unexpected expense like new tires or a doctor visit can throw many into debt. It's hard enough to save for expected expenses like retirement, let alone setting aside a little extra for those we don't see coming. Now you can help take some of the weight off those financial surprises by creating an emergency savings account for your employees.

Emergency savings within a retirement plan

Today when your employees face an emergency expense, there's a good chance they'll go to the qualified plan to take a loan or a hardship distribution. But tapping into savings earmarked for retirement typically only puts that individual further behind. It means they may not save enough or need to stay on the job a little longer – which can create added costs for you. Having a way for employees to save in an emergency savings account within the plan can provide a backstop, keeping their retirement savings intact.

How it works

To start an emergency savings plan within a qualified retirement plan, the plan needs to allow voluntary "after-tax" contributions. These are different from pre-tax and Roth elective deferral contributions. Next consider these actions:

- Encourage participants to first make elective deferrals to at least take full advantage of matching contributions, if available.
- Suggest participants make an election to direct a portion of their pay to the voluntary contribution account.
- Depending on the plan design, may want to allow participants to make an after-tax funds withdrawal at any time.

Weighing the pros and cons

Before offering an emergency savings account inside a qualified retirement plan, be sure to consider some of the potential pros and cons.

Pros:

- **Education.** Since employees already have a payroll deduction method for saving, there won't be much of a learning curve.
- **Cost.** It's likely a lower cost alternative with potentially higher rates of return than other investment vehicles. Plus, you may see a reduction in costly delayed retirements.
- **Access.** If voluntary contributions can be withdrawn at any point, employees have easy access to these contributions.
- **Productivity.** Having a rainy-day account for emergencies may reduce stress, leading to more productive employees. In fact, 53% of employees said they would be more productive at work if they didn't spend time worrying about personal finances.[3]

Cons:

- **Added administration.** Your payroll provider will need to track pre-tax contributions, after-tax contributions and, potentially, Roth elective deferral contributions.
- **Extra testing.** If you allow highly compensated employees to contribute to the account, you'll have to perform a nondiscrimination test to prove savings don't discriminate. For safe harbor 401(k) plans, adding the voluntary contribution account will make the plan subject to nondiscrimination testing and the plan will no longer deemed to satisfy the top-heavy testing requirements.
- **Tax considerations.** When employees take a distribution from the account, any earnings on the after-tax contributions will be taxable. Plus, employees may be subject to a 10% excise tax if they take a distribution before age 59 ½.

It's always a good idea to set aside a little extra for the unexpected. If your employees aren't acting on their own, adding a feature within the plan may help keep them out of debt.

Want to know more? Let's talk. We're here to help weigh the pros and cons of offering an Emergency Savings Account inside a qualified retirement plan.

[1] Bankrate article published March 15, 2018 – Source – Bankrates Financial Security Index Feb. 28 – March 4
[2] Report on the Economics Well-Being of U.S. Households in 2017 – Source – Board of Governors of the Federal Reserve System May 2018.
[3] Employee Benefit Research Institute, Perceived Helpfulness of Financial Well-being Programs: Results from the 2017 and 2018 Retirement Confidence Surveys, August 2018.