



AUTOSAVE

AUTOSAVE OVERVIEW

AutoSave is a unique savings plan that automatically diverts through payroll deduction a small amount of post-tax wages into a savings account. AutoSave's design incorporates key factors that encourage saving, such as facilitation of automatic transfers to a savings account through an existing system (here, payroll deduction) and use of defaults that simplify and ease decision making, requiring employees to take action *not* to save. To participate, employers would direct deposit a small amount of wages each pay period into individual or in some cases pooled AutoSave accounts on behalf of their employees. Individuals will have the flexibility to opt out of the system (as well as to increase or decrease the amount saved), and will be able to withdraw funds at any time without financial penalty. This new infrastructure, seamlessly enabling individuals to contribute small amounts of their wages into an accessible savings account, will be especially valuable for individuals who have limited liquid assets, and who may otherwise be forced to meet emergency liquidity needs with high-cost emergency loans.

THE AUTOSAVE PILOT

AutoSave utilizes a default mechanism to build savings into the payroll system, making the savings process automatic, flexible, and inclusive. The AutoSave pilot will test the concept's operational feasibility, attractiveness, and effectiveness to both employers and workers. Special attention will be focused on the population most in need of non-restricted saving accounts, workers in families at or below the 60th percentile of income (in 2006, the mean income for the third quintile was \$48,223). AutoSave could be set at 2 percent of wages, so that a worker earning \$50,000 would accumulate \$832 in after-tax savings each year, diverting \$35 per biweekly pay check. This would make a substantial contribution to unplanned expenses such workers are likely to face.

An initial pilot seeks to examine: (1) the feasibility of the direct deposit mechanism with default participation at a low contribution level; and (2) the value proposition of participation for the employee (does this automated mechanism aid

management of finances, facilitate savings and improve financial stability), the employer (do the benefits of providing AutoSave outweigh the costs), and associated financial institutions, and financial and workplace intermediaries.

THE NEED FOR NON-RESTRICTED SAVINGS

Savings are valued as a form of self-insurance, a key ingredient in one's sense of security, and as one's own personal safety net that can be tapped in the event of unanticipated expense. Savings behavior is associated with positive asset-building behavior, increased asset holdings, and lower overall use of non-traditional and personal network sources of credit. For households with fewer resources, non-restricted savings can be especially powerful as a lifeline to weather financial downturns or as the initial building blocks of asset accumulation.

Nationally representative surveys estimate that as few as 40 percent of Americans set aside funds for emergencies, with only half of these doing so through automatic and regular transfers from a checking account to a savings account. Fourteen percent of Americans report holding less than \$500 in those saving accounts. Recent survey research by the Center for Financial Services Innovation and the New York City Department of Consumer Affairs confirm that the underbanked consider saving for unexpected emergencies as the most important saving purpose or goal. A CFA survey suggests that the average American family incurs approximately \$2,000 in emergency expenses annually (for car repair, emergency dental or other household expenses).

Middle-income workers, much like lower-income workers, also lack sufficient personal savings to weather a major disruption in income, defined as not being able to withstand a personal crisis such as job loss or major illness without a decline in standard of living. According to a nationally representative survey of Americans workers commissioned by the Rockefeller Foundation, 67 to 73 percent of families earning less than \$36,000 report experiencing this financial strain, as do 47 percent of families earning \$36,000–\$57,999, and 43 percent of families earning \$58,000–\$91,999.

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AUTOSAVE RATIONALE

AutoSave is predicated on three principal rationales.

1. Working households require non-restricted savings accounts to cover unanticipated expenses.

While government programs and policies to encourage saving are focused on long-term goals and mainly benefit higher-income households, many households would benefit from a pool of non-restricted savings that could be tapped in an emergency. Each month, 15 million people, most of whom earn \$18,000-\$25,000, visit payday lenders where they are often charged an effective interest rate (expressed as an annual percentage rate) as high as 300-400 percent. The frequency of payday loan use and the sizeable income lost to fees suggests that a large share of the working population experiences liquidity problems and may not have access to lower-priced alternatives. For higher-income earners, automated savings could encourage the accumulation of a fairly substantial cushion in the event of job loss. Currently no systematic savings program exists to intentionally encourage short-term flexible savings.

2. Applying a “default” choice will improve savings.

AutoSave applies the most promising behavioral economics research that calls for the use of defaults to overcome emotional and psychological barriers that stymie reaching savings goals. This research finds that people value current losses (such as less money in a paycheck) over future gains (savings with interest) and are prone to inertia—to continuing an action once started. By defaulting people into saving and requiring them to take action to stop saving, AutoSave uses these tendencies to enhance saving. Employer-based retirement savings programs consistently demonstrate that simplifying the process of saving through requiring workers to “opt out” rather than “opt in” increases plan participation. AutoSave is designed to take advantage of one of the most tried and true savings techniques—inertia.

3. Employers are uniquely positioned to facilitate a savings mechanism.

AutoSave leverages existing infrastructure—payment mechanisms that automatically divert earnings to functions such as health insurance or retirement saving. This makes the workplace a logical place to enhance savings opportunities. Whereas only approximately half of employers offer retirement savings plans, flexible savings, which would entail no complex tax rules or matching requirements, can be easily adopted and implemented at low cost, by any employer directly depositing its employee payroll.

THE BENEFITS OF AUTOSAVE

The distinguishing feature of AutoSave is the employer and financial institution facilitated enrollment for workers to make possible regular, post-tax contributions to a saving account, which the worker controls and which can be used to smooth income, cover emergencies or start building assets. In contrast, many Americans do not have or contribute regularly to a savings account that allows non-restricted withdrawals to meet emergency and other savings needs. According to recent polling by CFA, “inadequate savers and non-savers” said that automatic transfers from payroll were important to their saving decisions (65 percent said important, and 36 percent said very important).

AutoSave offers a potential means to increase savings behavior and create access to financial services that support savings for versatile uses. A pilot will illuminate the operational and policy implications for government, employers and other stakeholders, and inform the proposed strategies needed to implement AutoSave broadly.

ABOUT US

The New America Foundation is a non-partisan, non-governmental policy institute based in Washington DC. New America’s Asset Building Program received a one-year planning grant from the Rockefeller Foundation to design the AutoSave pilot. With MDRC, a nonprofit, nonpartisan education and social policy research organization, we will develop the parameters for the pilot and evaluation during 2008, with a projected launch of the pilot in 2009.