Saving for financial shocks and emergencies

About half of households are considered financially fragile, which means they're not sure they could come up with $2,000 in 30 days if they had to.

Lack of emergency savings is common. It affects about half of households that earn $25,000 to $75,000 a year, and about a quarter of households that earn more than $75,000 a year.

For households without an emergency fund, financial shocks can hurt, both right away and down the road. Consumers may tap into long-term savings (such as retirement or college accounts) and pay losses and penalties. Or, they may skip paying bills or take out high-cost loans. These decisions are expensive in the short term, and they can make the situation worse in the long run.

Exploring the causes

Research shows that consumers have many reasons for their actions. To gain insight into why it's so hard for consumers to build savings to manage financial emergencies, consider these factors.

1. Resources running low

When consumers struggle to make ends meet, it's hard for them to think about anything else (the "psychology of scarcity"). Day-to-day needs are more urgent than preparing for a future emergency that may or may not happen.

2. Too easy to spend

Consumers can end up spending intended emergency savings at times when they are tempted by impulses, or when they are overwhelmed by life's challenges.

Inspired to help?

Think about ways you can make it easier for consumers to carry out their best intentions—or make it harder to slip up. The ideas below can help guide your brainstorming.

- Make savings automatic, through bank account features, payroll deduction, or at the time of a purchase
- Reward people for saving, emotionally or financially
- Show data on savings rates, to help people compare themselves to peers
- Change the way people think of themselves, as savers instead of spenders
- Help people better predict the likelihood of specific emergency events (such as a flat tire or broken washer), and the savings needed to fix the problem

3. Too hard to predict

Consumers underestimate how often financial emergencies happen and how much they cost. They may be too confident their finances will be better in future.

4. Lack of reinforcement

Each consumer has different peer groups, social roles, and identities that influence their decisions. In some groups and situations, the consumer's self-image and peer group could lead them away from savings.

Inspired to do more research?

The factors described above are starting points. You may want to dig deeper—for example, to find out which influences are strongest on different groups of consumers. You might ask questions like:

- What tradeoffs are made in households without enough financial slack? How expensive are those tradeoffs?
- How do consumers use their emergency savings, and for what? How easy or hard is it to spend the money? How does that affect how the money is used?
- How much do consumers think a financial emergency could cost, and how much do emergencies really cost? How have consumers changed their behavior after they go through a financial shock?
- Who do consumers consider their peers, and what do they think their peers do to save for emergencies?

Making a difference

Because nearly half of American households are unprepared for financial emergencies, solutions in this area can help a large number of people. And for this group, even small financial shocks can lead to large financial setbacks, so innovative products, services, and coaching can have high short-term and long-term impact.

ABOUT THESE IDEAS

The Consumer Financial Protection Bureau hired a group of analysts and researchers to investigate challenges that consumers face when they make financial decisions. The group reviewed published studies, talked to academics and financial experts, surveyed financial products, and looked at what actions consumers took—and why.

To pinpoint the most important challenges, the group set up a few categories: income, expenses, saving, borrowing, payments and transactions, and risk management. Then, the group looked into the causes of problems in these categories. Are there too few products and services that are safe, affordable, and high quality? Are there too many products and services that set consumers up to make mistakes? What else adds to the problems?

Finally, the group selected challenges that are based on consumer behaviors or decisions, widespread, possible to change, and possible to measure.

Sources: Lusardi, A., D.J. Schneider, & P. Tufano. "Financially fragile households: Evidence and implications." *National Bureau of Economic Research*, No. w17072 (2011). Lusardi, A. "Americans' Financial Capability." National Bureau of Economic Research, No. w17103 (2011). Chase, S., L. Gjertson, & J.M. Collins. "Coming Up with Cash in a Pinch: Emergency Savings and Its Alternatives." Center for Financial Security, University of Wisconsin-Madison (2011). Fletcher, M.A. "401(k) Breaches Undermining Retirement Security for Millions." *Washington Post*, January 14, 2013. Mullainathan, S., & Shafir, E. "Savings policy and decision-making in low-income households." *Insufficient funds: Savings, assets, credit, and banking among low-income households*. (2009): 121-45.