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Could ‘sidecar’ emergency savings help Canadian employees plan their financial futures?

Martha Porado | November 23, 2018

With many demands on employees’ money, could helping them build an emergency fund alongside their retirement savings make them more financially secure in the long run?

Last week, Britain’s National Employment Savings Trust Insight began piloting its new sidecar savings program, which aims to optimize pension savings while helping workers maintain a reasonable amount of liquid savings for emergencies. Nest noted that just 44 per cent of workers in Britain have £500 or more in liquid savings and 26 per cent have no emergency savings.

The sidecar structure aims to mitigate this illiquidity, allowing contributions above a pension plan’s **auto-enrolment** minimum to flow partly into a liquid savings account, in addition to a pension, until the funds reach a specific savings cap. After the cap, contributions will roll entirely into the pension pot. Should an emergency arise, depleting the liquid savings, contributions would again split between the emergency savings and the pension pot, until the cap is reached again.

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While creating mechanisms that help employees save automatically are usually helpful, creating more liquid components can be a double-edged sword, notes Joe Nunes, executive chairman of Actuarial Solutions Inc. “I really worry that regular withdrawals from an emergency fund will just cause the mechanism to essentially drain money away from long-term retirement savings,” he says. “It’s great if what it does is help people better prepare for emergencies, but it’s bad if all it does is create a mechanism where instead of saving for retirement you can just syphon off your retirement funds to deal with finances that you’re not managing well.”

It remains to be seen how people will react to the program, but Nunes notes a key finding in behavioural finance has been that workers have more retirement success when employers automate processes and nudge people in the right direction.

“It’s a nice feature,” says Malcolm Hamilton, a research fellow at the C.D. Howe Institute. “Having said that, the fact of something being attractive to a certain set of workers is never enough by itself to get Canadian employers to adopt it. They’ll want to know if other people do it. I don’t think it will just spontaneously arise from the demand of Canadian employers.”

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There’s also the issue of how employees gain access to the emergency savings, says Hamilton.

“You can describe it as an emergency account, but if a guy comes along and says, ‘I’m a little short and I need to buy a birthday present,’ do they automatically get the money or does someone say that’s an insufficient emergency? The more constraints you put on it, the more employers are inclined to suspect the financial judgement of their employees and the more reluctant employees will be to put money in it.”

Currently, Nest’s program has no restrictions on the funds. Over the next two years, beginning in 2019, it will monitor the pilot, which includes 5,600 British employees, to assess signup rates, saving levels and the impact on financial well-being.

“Financial well-being is an important part of this,” said James Timpson, chief executive officer of British retailer Timpson, which is piloting the program, in a press release. “We know that money worries can have a really negative impact on colleagues’ health, happiness and productivity at work. We’re delighted to be taking part in Nest Insight’s sidecar savings trial to help our employees become more financially resilient, both today and into their retirement.”

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