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EMERGENCY SAVINGS AND FINANCIAL WELL-BEING: Q&A WITH FINANCIAL EXPERT J. MICHAEL COLLINS

ABOUT PROFESSOR J. MICHAEL COLLINS

Professor J. Michael Collins [http://www.ssc.wisc.edu/~jmcollin/] is faculty director of the Center for Financial Security at the University of Wisconsin–Madison [https://cfs.wisc.edu/] . He is the Fetzer Family Chair in Consumer and Personal Finance in the School of Human Ecology [https://sohe.wisc.edu/sohe101/academic-departments/personal-finance/] , an associate professor at the La Follette School of Public Affairs [http://www.lafollette.wisc.edu/] , a family economics specialist for UW-Extension, Cooperative Extension, [http://www.uwex.edu/ces/] and an affiliate of the Institute for Research on Poverty [http://www.irp.wisc.edu] and Center for Demography and Ecology [http://www.ssc.wisc.edu/cde/] .

Collins's research focuses on household finance and low-income families. He examines consumer decision making and the influence of public policy on credit, savings and investment choices.

His book, A Fragile Balance: Emergency Savings and Liquid Resources for Low-Income Consumers [https://www.amazon.com/Fragile-Balance-Emergency-Resources-Low-Income/dp/113748781X] , explores successful strategies for low- and medium-income households to gain financial security and well-being.

Q: Why are emergency funds so important for people to have?

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From a household point of view, emergency savings give people peace of mind—or what we like to call "financial well-being," which is really defined as being subjectively OK with where you are. A big component of that is not worrying about stuff, being resilient to extra expenses, feeling in control. If you don't feel like you can set [financial] goals and reach them, it makes you feel less financially well. That has negative side effects for people's physical and mental health.

Alleviating some of that worry with a savings account helps people feel better. And this goes back to the long-term focus that helps them do things that are good for society as a whole.

Q: How much do you recommend an individual have in emergency savings? Does your recommendation change for low- to moderate-income families?

A: Financial planners will often say that people should save anywhere from 3 to 12 months' worth of expenses. Obviously more is better. But some people will hear that big number and feel discouraged. If you're making $50,000 a year you're probably thinking, "That's a lot of money! It's so intimidating." So I don't start with that recommendation. It turns people off.

Instead, I like to ask, "How much would it take for you to sleep better at night?" Some people will say, "I just want to be sure I can pay my mortgage for the next month should something happen." So you set your goal there. Or maybe it's one car payment. Or a rent payment.

That's something better to focus on: You break it down to one fixed expense that you worry about. Then, once you achieve that goal, you can expand it.

Q: Where do you recommend these funds reside? A savings account? A Certificate of Deposit (CD)?

A: It depends. If you already have a credit card and a checking account then you can find a free or very low-cost savings account. If you don't already have a bank account or credit card you may only be able to get a savings account with monthly fees.

If that's the case, you have to be careful. Read the fine print and pay attention to the fees. After all, if you've saved, say, $100 but are paying $9 a month for the account you put it in, you'll be in a negative balance before the end of the year.

CDs are really generational. Our parents' generation would absolutely use a CD. Younger people? Probably not.

A relatively new option that's not well-known is myRA [https://myra.gov/b/?utm_expid=112154954-16.PoKz1PlMSv2_bFzxCud1hg.1&utm_referrer=https%3A%2F%2Fmyra.gov%2Fb%2F] . You build up your savings directly with the U.S. Treasury, there are no fees and has relatively no risk because it's subsidized by the U.S. Treasury. And it's all online.

*my*RA is an after-tax retirement account so as long as you don't take out the interest there is no penalty. It does take a couple days to get your money out but, as with CDs, some people like that they can't access their savings right away.

Q: How do you suggest people stay out of debt and avoid predatory lending practices?

A: That's honestly one of the reasons I got interested in this work. I came to realize, "we can't ever end that cycle of people borrowing when they are in trouble. We can regulate lenders 'till the cows come home but what will stop people from borrowing when they need emergency savings?"

Helping people change their behaviors and gain financial security is really the only way to protect them from predatory lending. Now I'm asking, "How can we create a system to develop more independent financial capability? How do we get people to follow through and to focus on their goals?"

Financial coaching can work well. When people are committed to working with a financial coach we've seen reductions in debt in the thousands of dollars.

Q: How do you feel about income loss insurance?

After all, if you want to save up it's going to take a long time. And while you're saving, you're still worrying about how you will pay your bills in the event of a sudden major expense. Insurance gives you immediate alleviation from this worry. So it's something else to put in your tool box.

If people have a wider variety of tools available to them they are better able to increase their financial well-being.

Q: Are there certain qualities of supplemental income loss insurance you would advise folks to look for and/or avoid?

A: It all comes down to the fine print. That's what makes people really anxious about insurance. People wonder, "Will it really pay out? How hard is it to file a claim?"

When buying insurance we tend to focus a lot on the premium or what the payout will be, but people also need to pay attention to other issues like the claiming and payment process. It's important to ask, "What happens if you miss a payment? Will you be suddenly disqualified? Will there be a grace period? How hard is it to make a claim?"

Q: Why are you so interested in helping people gain financial well-being?

A: When we don't have the ability to help people manage their finances it hurts us all. If people feel they are always at risk of losing what they have and are always asking, "What will be the next road bump?" they make decisions based out of that fear.

To ward off feeling vulnerable and defensive, people need to have more tools to secure their financial well-being themselves.

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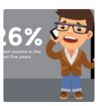

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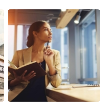

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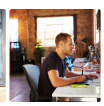

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