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Coping with a Crisis: Financial Resources Available to Low- and Moderate-Income Households in Emergencies

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Increasingly, research is shining light on the true costs of being poor. Much has been written about struggles to manage income constraints in low- and moderate-income (LMI) households, but another key problem has received less attention: Liquidity is also relatively constrained in many of these households; they do not have access to savings that could provide a buffer against unexpected shocks like drops in income or spikes in expenses. Though these shocks may be unexpected, they are not infrequent. An analysis of LMI tax filers found that about two thirds of respondents experienced a financial shock, such as a major vehicle repair, hospitalization, legal expenses, or unemployment, in the 6 months after filing their taxes.¹ Similarly, an analysis of data from the Pew Survey of American Family Finances found that 60% of households experienced a financial shock in the prior year and that the median cost of the most expensive shock was \$2,000.²

Many households also lack access to the financial resources required to offset these shocks. The 2015 National Financial Capability Study found that only 24% of low-income households had set aside 3 months' worth of income in an emergency fund and that 63% could not come up with \$2,000 in an emergency.³ Findings from a recent study by the Federal Reserve are even more concerning: 48% of households could not completely cover an emergency expense of just \$400 without borrowing money or selling possessions.⁴

This lack of financial resources has clear consequences for lower income households. Beyond impeding efforts to save for long-term goals like education, a home, and retirement, the scarcity of resources can have detrimental short-term effects. For example, when individuals with constrained resources and low incomes face an emergency, they may focus on short-term needs as opposed to the longer term impacts of a high-cost

payday loan taken to meet such needs.⁵ Or, they may forgo participation in the formal banking sector due to account balance requirements and the associated fees.⁶ More tangibly, they may be one financial shock away from falling into a feedback loop of debt accrual and income

Key Findings

- » Friends and family were the most commonly cited source of financial support in a potential emergency, and 10.5% of respondents indicated that reaching out to friends and family was their only option.
- » Twenty-eight percent of respondents reported that they could only draw on resources outside of traditional financial products like checking and savings accounts (e.g., payday loans, friends and family).
- » Among exceptionally resource-constrained households (those that could come up with less than \$1,000 in an emergency), the second most frequently identified source of emergency support, after friends and family, was selling and pawning items.
- » Resource-constrained households were generally much less likely to rely on traditional financial products (checking accounts, savings accounts, and credit cards) and more likely to depend on alternative financial services like payday loans.
- » Of respondents who reported that they would consider using payday loans in an emergency (10% of the full sample), 26% indicated that payday loans were their first or second option.



Table 1. Demographic and Financial Characteristics of HFS Respondents

Characteristic	%, Mean, or Median
Race (%)	
Black	8
White	82
Female (%)	59
Single filing status (%)	70
Employment (%)	
Full time	45
Part time	30
Unemployed	25
College degree or greater (%)	50
Age (mean, years)	36.9
Adjusted gross income (mean, dollars)	15,486
Emergency resource access	
Most money could find in emergency (median, dollars)	1,000
Can come up with \$2,000 in emergency (%)	44

Note. HFS = Household Financial Survey. Observations range between 8,554 and 9,927.

loss—one unmanageable car repair can lead to job loss, maxed-out credit cards, a degraded credit score, and eviction or foreclosure.

As lower income Americans remain vulnerable to financial shocks and lack the requisite savings to manage them, it is important to understand what resources they rely on to weather these emergencies. To that end, this brief uses 2014 data from the Refund to Savings (R2S) Initiative to explore the resources available to lower income households in emergencies, how they prioritize these resources, and how emergency resource access is mediated by participation in mainstream banking institutions and by existing resource constraints. Understanding these aspects of LMI households' financial reality leads to important implications for the design of policies and programs.

Background

The collaborators of the R2S Initiative use behavioral economics to develop innovations to increase savings behaviors in LMI households at tax time. The initiative is a collaboration among Washington University in St. Louis; Duke University; and Intuit, Inc., the maker of TurboTax. Through an ongoing series of randomized, controlled trials, R2S tests the impact of behavioral interventions on users of TurboTax Freedom Edition (TTFE), a free self-prepared tax product accessed online and developed by Intuit, Inc., as a part of the IRS Free File Program.⁷ To qualify for TTFE in 2014, a household was required to have had an adjusted gross income of \$30,000 or less in the 2013 tax year, to have been eligible for the Earned Income Tax Credit, or to have had an active military member in the household and a household income of less than \$58,000.

This analysis draws from the survey component of R2S, the Household Financial Survey (HFS). If a TTFE user's filing indicated that a federal refund was due, the software invited the user to participate in this survey when he or she completed tax filing. Data from the

survey were matched with other data collected on the user by TTFE. The 2014 HFS sample used in this analysis consisted of 10,416 households.⁸ Table 1 outlines the demographic and financial characteristics of the sample. Tax filers in the HFS had an average adjusted gross income of \$15,486. Most respondents filed as single (70%), 59% of HFS respondents were female, and the mean age of respondents was 37 years. The majority of respondents identified themselves as White (82%).

These households appear vulnerable to potential financial emergencies or shocks. The survey asked respondents to specify "the most money you could come up with in the next month if an unexpected need arose,"⁹ and the median amount indicated was just \$1,000. Fewer than half (44%) reported that they could come up with \$2,000 in an emergency. Further, 24% reported that they could come up with less than \$500 for an emergency. These results are somewhat similar to other national surveys like those referenced above, though respondents in this study report somewhat higher levels of resource access than those in the Financial Capability Study or the Survey of Household Economics and Decisionmaking.¹⁰

It is important to note that this question in the HFS did not focus specifically on assets held by the household but instead asked about the value of accessible resources in general. For respondents, those resources could include credit products, support from friends and family, alternative financial services, and pawn shops. Though the level of liquid savings held by lower income households in the HFS sample is generally very low, these results suggest that lower income households may face liquidity constraints beyond their low asset levels.

Response Options from the Emergency Resources Measure

The first 10 response options were presented in random order, followed by the remaining two options in the order shown:

- » Withdrawing from checking (or cash)
- » Withdrawing from a savings account
- » Charging to a credit card
- » Borrowing from friends or family
- » Overdrafting and paying a fee
- » Taking out a payday loan
- » Taking out a title loan
- » Withdrawing from a retirement account
- » Pawning or selling household items
- » Taking out a home equity loan
- » Other (please specify)
- » None of the above/I prefer not to say

Respondents could select more than one option.

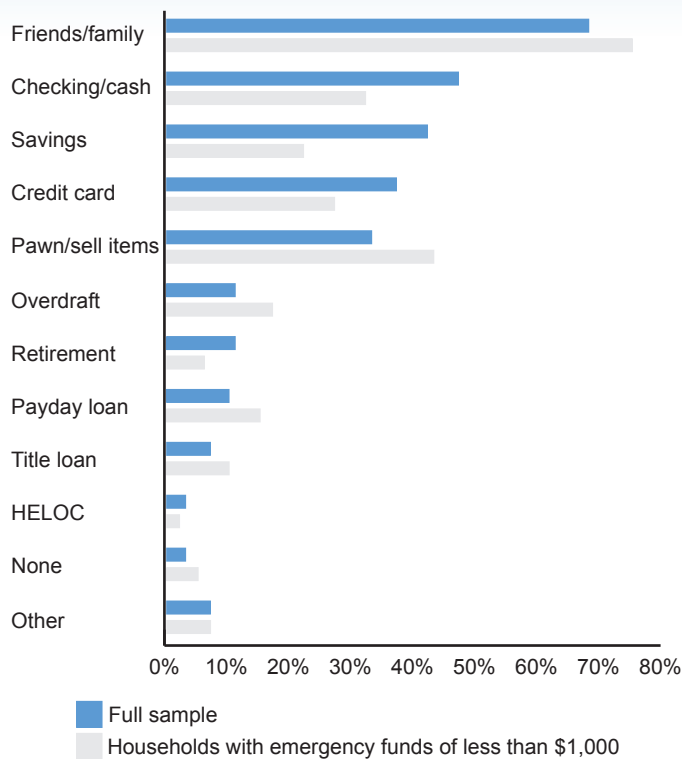


Figure 1. Resources respondents would consider using in a financial emergency (n = 9,887). HELOC = home equity line of credit. Significant differences between those with resources below the median and above the median were tested via chi-square tests. All differences were significant ($p < .05$).

Access to Resources in an Emergency

When lower income households are faced with a shock, how do they cope? To answer that question, we asked HFS respondents what resources or methods they would consider using to manage a financial emergency. The survey did not specify the nature of the shock, so respondents could define “emergency” according to their own understanding.

Figure 1 presents the results for both the full sample of respondents and for those who had less than the median amount of resources available to them for an emergency (\$1,000). Comparing how available sources of financial support for those who are relatively resource-constrained (in an already constrained population) differ from the sources available to the general sample sheds light on the ways in which the most financially vulnerable households deal with hardship.

Friends or family were by far the most commonly mentioned resource for coping with a financial emergency. About two thirds of the sample indicated that they would consider borrowing from friends or family. The prevalence of this choice underscores the importance of social and familial networks in the financial lives of lower income households. Friends and family were a source of support for an even greater share of the households that could access less than \$1,000 for an emergency: Three fourths of respondents from those households indicated that they would rely on their social or familial networks in an emergency.

Though 94% of respondents in the sample reported having a checking account, only about 47% indicated that they could rely on checking account funds or cash to manage a financial emergency. This may indicate that, even as households have access to bank accounts, their account balances are not robust enough to help them weather an emergency. As evidence of this, the median amount held in these highly liquid assets was \$1,000 for households that would consider withdrawing from these sources and \$300 for households that indicated they would not consider these resources. Similarly, 75% of respondents reported having a savings account, but only 42% of the sample indicated that they would consider withdrawing from a savings account to address an emergency. In looking at savings accounts, the gap in assets between those who would rely on savings accounts in an emergency and those who would not is even more striking. Among savings account holders, those who would consider drawing on the account in an emergency reported having a median of \$1,000 in their savings accounts while respondents who would not consider drawing on savings accounts in an emergency had a median of only \$77 in those accounts. This further suggests that low balances deter people from considering bank accounts as emergency resources. Only 37% of respondents (and 54% of those owning a credit card) said that they might rely on credit cards to address a financial crisis.

Figure 1 suggests another noteworthy trend related to the “traditional” financial products commonly used in an emergency: checking accounts, savings accounts, and credit cards. The figure shows that households with less than \$1,000 in emergency funds would consider these products at substantially lower rates than would households with more resources. This indicates that households with access to less than \$1,000 in emergency funds were not only constrained in terms of their tangible assets (cash and bank deposits), but also that they were constrained in the amount of liquidity they could draw from credit products. The fact that these households were relatively constrained in terms of both liquid assets and credit likely means that they were exceptionally vulnerable to shocks.

Outside of the use of traditional financial products and social resources to weather a shock, a third of sampled respondents said that they would consider pawning or selling household items in the event of an emergency, while fewer than 12% would consider relying on payday loans, account overdrafts, retirement accounts, or title loans. Among those reporting that they would consider using payday loans (10% of the sample), 26% reported that they considered payday lenders to be either their first or second option in an emergency. Among those reporting that they might use title loans, 21% reported that they considered such services to be their first or second option. Unsurprisingly, the rates of willingness to consider these options were substantially higher among households with emergency funds of less than \$1,000 than among the full sample.

About 7% of respondents selected the Other option and wrote in a response. Popular write-ins included

Table 2. Emergency Resources by Bank Account Ownership (Percentages)

Emergency Resource	Unbanked (n = 422)	Banked (n = 8,873)	Chi-Square Statistic	p
Credit card	7	39	175.5	***
Friends/family	71	68	1.4	
Pawn/sell items	49	32	48.8	***
Overdraft	8	11	5.2	**
Payday loan	14	9	11.1	***
Retirement account	4	11	25.2	***
HELOC	1	3	3.3	*
Title loan	11	7	8.6	***
Other	9	7	4.1	**

Note. HELOC = Home Equity Line of Credit. Significant differences measured using chi-square tests. As these results are contingent on bank account ownership, checking and savings accounts are suppressed as resources.

*p < .10; **p < .05; ***p < .01.

withdrawing from other assets (20% of Other responses; e.g., cashing out bonds, insurance policies, and mutual funds), taking out other kinds of loans (18%; e.g., loans from employers and personal bank loans), and increasing income by working more (14%; e.g., working overtime, extra shifts, and odd jobs). About 11% of responses assigned to the Other category alluded to the inability to handle an emergency (e.g., “I have no options,” “emergencies just can’t happen,” and “suicide”). Other write-ins referenced seeking help from social services or charities (5%), reducing expenditures (3%), prayer (3%), and illegal activities (3%).

Resources for the Banked and Unbanked

Unsurprisingly, participation in mainstream banking institutions was associated with the resources that households

said they would consider relying on in an emergency. About 5% of the sample was unbanked, and that percentage is slightly lower than the percentage of unbanked households in the general United States population (8%).¹¹ Table 2 presents the emergency resources available to banked and unbanked households.¹² The rates of willingness to consider credit cards, home equity lines of credit, retirement accounts, and bank overdrafts were significantly higher among banked households than among unbanked ones. This is likely because participation in the formal banking sector is associated with access to such accounts. Conversely, the rates of willingness to consider alternative financial services (pawning, payday loans, and title loans) were substantially higher among unbanked households than among their banked counterparts. These differences largely hold if the definition of unbanked is expanded to include households that used any alternative financial service (such households are often referred to as being “underbanked”). Interestingly, banked and unbanked households did not differ significantly in the rates at which they reported that they would consider relying on friends and family. This indicates that family and friends remain a common source of potential emergency support, regardless of whether one participates in the formal banking sector.

How Do the Different Emergency Resources Interact?

On average, participants identified 2.7 resources that they would consider relying on in an emergency, and Figure 2 presents the 15 most common combinations of emergency resources, which represent 49.5% of all combinations selected by respondents. About 10.5% of respondents indicated that they would *only* consider relying on friends and family in a financial emergency.

Figure 2. The most prominent combinations of resources available in a financial emergency. This figure represents the top 15 combinations of response selections for a question about what resources would be considered in a financial emergency. These combinations account for about half the sample (n = 4,892 out of 9,887).

Combination Rank	Resources Available in an Emergency						% Choosing Each Combination	Cumulative %
	Friends/Family	Checking/Cash	Savings	Credit Card	Pawn/Sell	None		
1	x						10.5	10.5
2	x	x	x	x			4.8	15.3
3	x	x	x				3.8	19.1
4	x				x		3.7	22.7
5			x				3.3	26.1
6						x	3.0	29.0
7		x					2.5	31.5
8	x	x					2.4	33.9
9		x	x				2.3	36.3
10		x	x	x			2.2	38.5
11	x			x			2.2	40.8
12	x	x	x	x	x		2.2	43.0
13				x			2.2	45.2
14	x	x		x			2.2	47.4
15	x		x				2.1	49.5
Count	9	8	7	6	2	1		

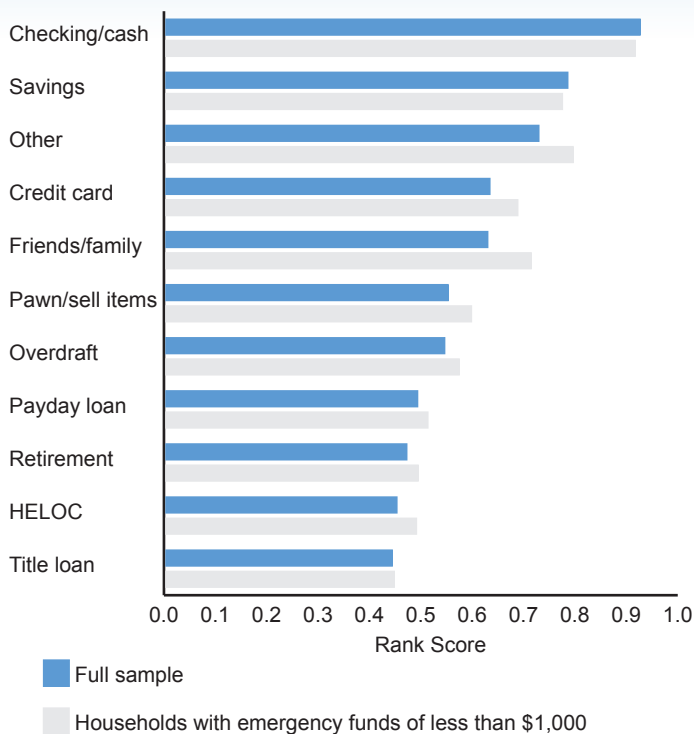


Figure 3. Rank scores for sources of funds to manage a financial emergency ($n = 8,097$). HELOC = home equity line of credit. Scores represent the relative ranking of the resource, regardless of the frequency with which it was chosen.

This was the most common response. This result is especially concerning because it suggests that a substantial proportion of lower income households did not have any direct access to financial resources in an emergency. Indeed, 28% of respondents reported that they would only consider relying on resources outside of traditional financial instruments (e.g., friends/family, pawn shops, payday loans, title loans, and overdrafts).

Which Resources Do Lower Income Households Rely On the Most in an Emergency?

After respondents identified the resources they would consider using, they ranked the order in which they would use those resources. Participants only ranked items they would consider using in a financial emergency; a person who selected five resources ranked only those five, and someone who selected two resources only ranked those two. To evaluate their rankings, a rank score was calculated for each participant's selected resources. The following equation was used for these calculations: $(k + 1 - d)/k$, where k is the number of ranked items, and d is the raw rank (1 is first, 2 is second, etc.).

For example, imagine that a person ranked three resources in the following order: (1) withdrawing from a savings account, (2) charging to a credit card, (3) borrowing from friends and family. The rank score for the savings account would be calculated as $(3 + 1 - 1)/3 = 1$; the score for the

credit card would be calculated as $(3 + 1 - 2)/3 = 0.66$; and the score for friends and family would be calculated as $(3 + 1 - 3)/3 = 0.33$. Through this method, top-ranked items always have a rank score of 1, and less favored choices have rank scores that are fractions smaller than 1. This enables a relative ranking of options. The higher a resource is ranked, the closer its rank score is to 1; the lower a resource is ranked, the closer it is to zero. Respondents who only selected one resource were not asked to rank, but that resource was assigned a rank score of 1. Unranked resources did not factor into the mean rank scores, which are presented in Figure 3.

Although friends and family were the most frequently identified resource that respondents would consider for managing an emergency (see Figure 1), on average, participants gave higher ranks to several other options, including withdrawing from checking or cash, withdrawing from a savings account, and using credit cards. Thus, those options had higher rank scores than that for friends and family, indicating a preference for those resources.

Notably, households with access to less than \$1,000 in emergency funds did not differ much from the full sample in the ranks they assigned to resources. That is, these resource-constrained households differed from the full sample in the resources they would *consider* using (Figure 1) but did not differ in their ranked preference for using these resources (Figure 3). This may indicate that the resource-constrained households preferred to weather emergencies by turning to traditional financial products rather than to friends and family, account overdrafts, and alternative financial services. Put differently, when the resource-constrained households reported having access to mainstream financial options for weathering shocks, they preferred to use those options over alternatives. However, these resource-constrained households had less access to mainstream sources of support and thus disproportionately reported that they would rely on alternative financial services.

Figure 4 takes the results from the preceding analysis and weights them by the overall incidence of the resource being used. Higher weights are given to resources (e.g., friends and family) identified by many households than to resources (e.g., home equity lines of credit) identified by comparatively fewer households. By using the ranking method outlined above, we are able to identify the overall emphasis given to each resource by the different groups. For example, a resource like those in the Other category, which was mentioned infrequently but ranked highly, would receive less weight than friends and family, which were mentioned very frequently but ranked in the middle. These results show that, for the exceptionally resource-constrained households, friends and family were by far the most prominent source of support in the event of a shock. For the general sample, friends and family were important but were relied upon about as much as cash and resources in checking accounts. Credit cards were also identified as a

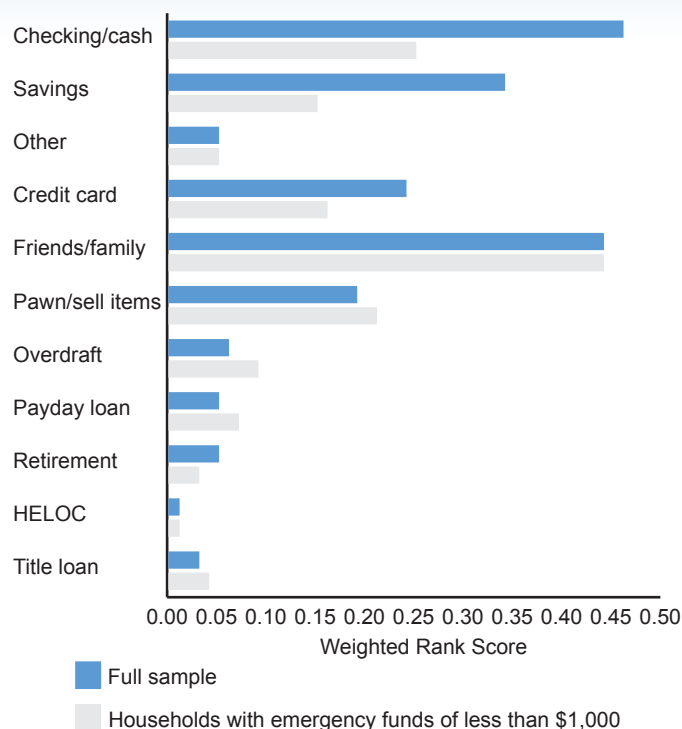


Figure 4. Weighted rank scores for sources of funds to manage a financial emergency (weighted by frequency respondents chose each source; $n = 8,097$). HELOC = home equity line of credit. Emergency resources are displayed in the same order as Figure 2 for ease of contrast.

much more common source of support for the full sample than for the resource-constrained subsample. Pawning items for an emergency was a somewhat prominent option for both groups, though 13% of respondents listed it as their first choice.

Conclusion and Policy Implications

The key takeaway from this brief is that, even as lower income households often must rely on emergency financial support from sources outside mainstream financial institutions, they still demonstrate a preference for using resources from those institutions to buffer the effects of emergencies. This brief has also shown the extent to which lower income households would consider alternatives to mainstream institutions. Friends and family were the most common source of support: About two thirds of respondents in this sample would consider reaching out to friends or family to cope with a financial emergency. These social resources often have the benefit of lacking explicit costs associated with using other resources like credit cards or payday lenders. However, 11% of respondents in this sample marked friends or family as their *sole* emergency resource, and 28% said that they could only rely on nonmainstream financial resources (friends and family, payday loans, pawn shops, etc.). Therefore, it is clear that this already vulnerable population would benefit from enhanced participation in traditional financial institutions.

While most households had access to a checking account, many lacked the resources within their accounts to provide

a reasonable buffer in an emergency and also appeared to lack access to affordable credit products that can provide liquidity in a crisis. Indeed, all else being equal, these households seemed to prefer relying on conventional financial institutions before they sought support from their social networks or alternate financial services. This exploration of how LMI households ranked the resources available to them in an emergency is essential to understanding the financial realities of these households and represents a unique contribution of this work.

When asked to rank their available resources to weather a financial emergency, respondents ranked checking accounts, savings accounts, and credit cards higher than any of the alternatives like payday loans, title loans, and pawn shops. Put differently, while many people relied on alternative support sources, this was likely because more conventional options were either exhausted or unavailable, and this dynamic is particularly apparent when looking at exceptionally resource-constrained households. Overall, this finding reinforces the central point of this research: A lack of liquidity to weather shocks was associated with people considering alternative sources of financial support.

These alternative resources come at a cost. Payday loans, title loans, pawning, and even drawing from retirement savings can all pose substantial costs and risks to this already-vulnerable population. High fees and interest rates can trap households in cycles of debt. Selling possessions and prematurely drawing down retirement savings can hinder the household's long-term well-being. Though borrowing from friends and family is likely safer than these alternative options, it can carry substantial social costs if a large swath of the population relies on social networks when shocks arise. For example, providing financial support to poor relatives has been linked with significantly lower wealth accumulation in households, and other research has shown that a substantial proportion of LMI households (24%) had outstanding debts owed to friends and family at the time they were surveyed.¹³ As such, pursuing programs and policies that can extend liquidity to resource-constrained households in times of crisis may help LMI households avoid relying on alternative financial services or their social networks for support. And in helping them to do so, such efforts may provide substantial social dividends.

This brief also presents evidence that policies to regulate alternative financial services, like a recent Consumer Financial Protection Bureau proposal to regulate the costs and structure of payday and title loans,¹⁴ may improve the welfare of households that rely on these services in emergencies by lowering fees and protecting them against predatory loan structures. However, it is also worth noting that over a quarter of respondents who would rely on payday loans would use payday loans as their first or second resource in a financial emergency. This indicates that high-cost alternative financial services may be one of the

first or only lines of defense certain households have in a financial emergency, and steps should be taken to provide these households with alternate sources of liquidity if the availability of payday and title loans is diminished as a result of regulation. Exploring why these households choose to use payday loans first, and why they do not have other resources to turn to in the face of a financial emergency, is beyond the scope of this paper, but further research should consider whether and how the updated rules would affect these households' ability to access payday loans, which are clearly needed and/or preferred by a subset of LMI households.

The finding that resource-constrained households prioritize liquidity in checking accounts, savings accounts, and credit cards to weather shocks if they had access to (or adequate resources in) those products is important for the development of policies targeting these populations, as is the finding that these households must rely on social networks and alternative financial services. By pursuing policies and programs to provide access to emergency resources, policymakers may reduce the reliance of these households on their families and on high-cost lenders.

Also important is the finding that even lower income households like those in the HFS sample rely on credit as a primary buffer against shocks. Although much of the discussion around providing resources to the poor is focused on the important issue of savings and asset accumulation, it is also important to develop simple, affordable credit products that can offer alternatives to reliance on payday lenders, missed payments, or selling possessions to a pawn shop.

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Disclaimer

Statistical compilations disclosed in this document relate directly to the bona fide research of, and public policy discussions concerning savings behavior as it relates to tax compliance. Compilations are anonymous and do not disclose information containing data from fewer than 10 tax returns or reflect taxpayer-level data with

the prior explicit consent from taxpayers. Compilations follow Intuit's protocols to help ensure the privacy and confidentiality of customer tax data.

End Notes

1. Grinstein-Weiss, Russell, Tucker, and Comer (2014).
2. Pew Charitable Trusts (2015).
3. FINRA Investor Education Foundation (2016).
4. Board of Governors of the Federal Reserve System (2014).
5. Rawlings and Gentsch (2008); Shah, Mullainathan, and Shafir (2012).
6. Barr (2004).
7. For more information on the Free File Program, see <https://www.irs.gov/uac/about-the-free-file-program>
8. The sample size in this brief may vary from question to question due to respondents having the option to skip questions. Responses from incomplete surveys are included to maximize sample size.
9. The exact language of this question references an "unexpected need" rather than an "emergency."
10. Board of Governors of the Federal Reserve System (2016); FINRA Investor Education Foundation (2013). It is important to note, however, that neither of these surveys is directly comparable to the HFS due to differences in the samples and approaches to measuring resource access.
11. Federal Deposit Insurance Corporation (2014).
12. For the purposes of this analysis, a banked household is one in which a household member reported owning a checking or savings account.
13. Chiteji and Hamilton (2005); Grinstein-Weiss, Oliphant, Russell, and Boshara (2015).
14. Consumer Financial Protection Bureau (2016).

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