Next steps for financial resilience

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INTRODUCTION

In 2012, Demos published a ground-breaking investigation into the multidimensional nature of poverty in the UK. The purpose of this work was both to expand our understanding of financial vulnerability in the UK and to allow policy-makers to better target support at different groups, experiencing different kinds of financial vulnerability. The truth – as that research demonstrated – is that absolute or relative income poverty are not sufficiently nuanced metrics for understanding the scale and nature of the UK's problem with financial resilience. Many families are income rich but lack the capacity or the resources to respond to financial shocks or sudden earning gaps. Many individuals have built up significant assets that give them the impression of overall wealth but lack the liquidity to manage their financial lives successfully. None of this detracts from the very real issues faced by those living in absolute or relative poverty – nor from the pressing need for Government to identify interventions that help families and individuals in that position to improve their financial situation – but it does point to the need for a suite of interventions that address financial resilience rather than straightforward financial deprivation.

For this reason, Demos has made financial resilience a core area of research and advocacy in our work. Over time, we have come to see that the impact of financial resilience on society more widely is profound and often overlooked. How resilient individuals and families are has a measureable effect on a range of outcomes – from emotional wellbeing to educational attainment.[1] But a lack of financial resilience has repercussions far beyond the household or family unit level. Individuals and families who are more financially resilient are more stable, less prone to severe detriment in the event of a financial shock and less reliant on the state. They are more autonomous and better able to cope with financial shock – making them less likely to depend on welfare, exposing the state to less financial risk and allowing taxpayer funds to be focused more effectively on tackling deprivation directly.[2] A more financially resilient populace is happier, more likely to meet its potential and less likely to call on the resources of the state. For us, these questions become both more important and more complex in periods of fiscal restraint.

It is this ongoing interest that led Demos to convene a high-level roundtable, in May 2016, to discuss the potential for new interventions and ideas to improve the overall financial resilience of the UK population. In partnership with Legal & General – who explore these very questions as a central part of their everyday business – we brought together leading representatives of Government, business, the charity sector and from academia. Together, we explored how Government, business and individuals can work together in order to develop new settlements and new products to improve financial resilience – addressing the practical, ethical and political dimensions underpinning these issues. This paper does not represent the individual view of any participant and it should not be understood as claiming to speak for those who generously gave their time and expertise. Rather, we have sought to capture the spirit of the debate and to relay some of the ideas for progress that were mooted and which provoked interest from those present (though, as noted earlier, not necessarily consensus). This short paper will serve as the platform for further research and advocacy from Demos in this area and – we hope – will provoke further discussion and debate amongst stakeholders and experts as we collectively seek to improve financial resilience through both new products and new policy.

WHAT WE LEARNED

As noted above, there was much healthy disagreement and debate in the course of the roundtable and nothing in this, follow-up paper should be read as representing the settled view of any participant or contributor. Nonetheless, there was a clear and welcome sense from experts from across a range of sectors that the UK suffers from a lack of financial resilience and that this matters at both the household and the societal level.

Participants also coalesced around a number of themes on which there was broad – though not unanimous – agreement. What is interesting about the themes outlined below is that they each represent a potential policy avenue that can win agreement from different political places. Each holds the potential to convene a coalition of political interests and each therefore, we believe, could be useful to moving the debate about financial resilience on.

Money in the wrong places

It is a paradox of financial resilience that income and wealth are not always the best predictors of an individual's ability to respond well to financial shocks. A family that is well covered by critical health or income protection insurance – for example – may be much more resilient to the financial implications of treatment for a long-term illness than a family which earns more month to month but has little in the way of insurance protection.

The relative liquidity of an asset is also very important in determining its relevance to resilience. And this is why it matters where money is, not just how much you have. This is a particularly pressing issue for Britain's older population, which tends to be asset rich and cash poor – with a detrimental knock-on effect on financial resilience. During the course of the roundtable, participants kept returning to the particular problems faced by older people who have built up significant wealth in their property but who can struggle to realise and make-use of that wealth when it comes to mitigating the financial shocks that can come with retirement and potentially worsening health. Legal & General analysis shows that the 'typical' retired person has around £250,000 tied up in the value of their home – a significant resource that, if unlocked, could revolutionise the financial resilience of Britain's pensioners. But despite the possibilities for financial wellbeing tied up in many millions of people's homes rates of both strategic downsizing and equity release remain low. Participants felt that a lack of opportunities for individuals to find purpose-built, suitable and affordable housing to downsize into meant that many older people stay in their homes long after they might wish to release a portion of the value by selling up and moving on.

Aside from the detrimental impact on older people themselves – which is important in its own right – participants felt that issue of money being 'in the wrong place' had a series of knock-on consequences that also impact financial resilience more broadly. Firstly, it was argued that the illiquidity of pensioner wealth is a motivating factor for Government in the provision of universal pensioner benefits that would otherwise be ripe for means testing or abolition. Free bus travel, the Winter Fuel Allowance and the free TV licence (although this will in future be funded via the licence fee) cost the taxpayer almost £4 billion per year.[3] A more financially resilient older population would be less likely to present as at immediate and dramatic risk from financial shocks and would therefore, arguably, be less in need of stabilising welfare such as the Winter Fuel Allowance. Secondly, many participants felt that helping older people to downsize would have a positive impact on intergenerational welfare from a financial resilience perspective. It was pointed out that the average age at which individuals are able to buy their first home in the UK is now 31 (older in the South East).[4] The pre-eminent factor in the escalating cost of a home is the lack of home-building that plagues the UK housing market in general. But creating opportunities for older people to vacate family homes and downsize to more suitable housing would help to alleviate some of the pressure in the middle of the market, potentially reducing the cost of housing and helping younger people to acquire and grow an asset of their own.

Everybody's business

There was a considerable amount of consensus, too, about the positive role that the private sector should be playing in helping to drive up financial resilience in the UK. For some, this was a matter of social justice. As one participant argued "it isn't good enough for employers to say this is none of their business and then be relying on the state all the time to give them a workforce that has welfare to fall back on without them playing a role themselves".[5] For others, the role of employers and of the financial services industry was more about pragmatism. It was argued, for example, that in a period of fiscal retrenchment it would be necessary for individuals to be guided towards products that insulate them from financial risk without recourse to the state. Finally, for some participants, there were intrinsic benefits to using employers and financial service providers to deliver at least part of the solution. The case was made, for instance, that the financial services industry was more likely to be able to innovate products that suited a wider variety of household type and financial circumstance than the state is able to – delivering more bespoke solutions that fit more neatly into peoples' needs at varying points of their lives and generate less in the way of dead weight costs.

There were concerns about the role of the private sector too, though. Scandals such as Payment Protection have undoubtedly knocked consumer confidence in some areas of the financial services industry – and not without cause. The financial crash of 2008, and subsequent fall out, has done little to persuade the public of the sector's ethics either. What's more, some participants worried that any solution which demanded further detailed consideration and choice on the part of consumers was doomed to succeed only amongst the most financially savvy consumers. After all, the argument went, there are already considerable numbers of people who would rationally benefit from forms of critical health or income protection cover – or even from much simpler products such as a savings ISA – who do not choose to protect themselves in this way despite being able to afford to do so. In the context of low public trust and questionable appetite for 'shopping around', it was felt that leaving individuals to choose from existing products and then subsidising those choices in some way (say through tax allowances or rebates) may prove ineffective in really driving better resilience into areas of the population most at risk.

Participants were enthusiastic about workplace solutions – and about initiatives such as pension auto-enrolment - which were seen as opportunities to bring the employers and individuals into partnership in thinking about and planning for financial shocks. The success of auto-enrolment was commended around the table and many felt that, as a mechanism, it offered the potential for further improvements to financial resilience. In particular, auto-enrolment's mix of limited choice and employer contribution with the preservation of individual autonomy was seen as attractive. But participants were clear that the state must continue to act as a backstop and architect so that individuals' choices were well-informed, well-targeted and well-protected. Solutions involving the private sector were generally agreed to be desirable, therefore, but also in need of careful planning and regulation.

Honesty is the best policy

Clarity was agreed to be absolutely central to any attempt to drive up financial resilience. Participants felt that families needed to be clear about both the financial risks that they face and about the extent to which they are currently protected – both by the state and by any private provision they have acquired. Some participants argued that the direction of Government policy – on pensions and on welfare – provided a positive first step in this direction.

On welfare policy the Government has laid out a fairly consistent direction of travel that – whilst controversial in its roll-out and policy specifics – has won some consensus at the level of principle. On pensions and unemployment welfare alike, the direction of travel is away from complexity and towards universality. Leaving aside questions over the pace and scaleability of reform, the Universal Credit is pitched at providing both Government and families with a simple and readily calculable level of cover in the event of unemployment. This reflects the principles that have sat at the heart of reform to the state pension over the last 6 years. Moving towards a single, universal level of state pension provides individuals and families with certainty about their financial situation vis-a-vis the state.

None of that is to say that the level of provision – at either pension or welfare level – is enough to sustain most individuals in the event of unemployment or retirement. There are very few people who would be content to live on £142 a week (the Single Tier State Pension) or, indeed, on less than £100 per week (the average Universal Credit receipt). But greater certainty does give people clear-cut options about what private solutions they might seek in order to augment what the state can provide. Most of us recognise that we will need to save, using one vehicle or another, in order to top-up our state pension. Across a range of other areas that represent financial shocks, of one form or another, the state cannot or will not continue to provide end-to-end protection. In these areas perhaps as the state retreats it will need to provide clarity and certainty to individuals and families so that they can plan properly.

However, there was widespread concern around the table that this apparent progress could in fact prove counter-productive. Some challenged the idea that the state pension – and the 'triple lock' which guarantees its rate of increase – is sustainable or likely to survive in its current form much beyond this Parliament. Far from providing families with certainty or clarity, so this argument went, 'gimmicks' like the triple lock actually give people a false sense of security about the future – one that is not borne out by close inspection of the whole of government accounts.

It is clear that the messages Government sends about the level of protection it will provide to families play a profound role in determining what families will then themselves do to insulate themselves from financial risks. That being the case, clarity is important and honesty - in the long-term – is the best policy. But political incentives understandably dictate that it is far easier for a Chancellor of the Exchequer to reassure people that their pensions are protected than to admit that current levels of provision may not be sustainable. A way of squaring this policy circle would be useful to giving individuals and families firm ground on which to plan for their futures.

NEXT STEPS

Following the roundtable, Demos has explored the themes that emerged and given thought to what policy interventions designed around them might look like. These are not intended to be firm or fully-developed policy recommendations to be implemented tomorrow. Rather, they are representative of what solutions built on the above themes might look like. We hope that they will spark debate and discussion – and, indeed, alternative proposals.

A downsizing revolution

The UK needs a revolution in planning law to revolutionise the availability of tailor-built accommodation for older people. This is not simply important because it will enable the many older people who say they wish to downsize the chance to do so. It could have a huge effect on financial resilience by freeing up equity for older people, reducing the need for state provided universal pensioner benefits and reduce the cost of family housing in the South East by easing the current market bottle-neck.

At present, retirement housing represents just 2% of UK housing for the over 65s – making it a tiny proportion of available stock.[6] We need to improve financial resilience in older people, allow Government to better direct resource and free-up housing stock by unleashing the supply of specialist housing for older people. In previous research, Demos has identified the planning system as the key barrier to improving the supply of such housing and it is here that Government should focus if it is to help older people become more resilient by enabling them to better use the resources at their disposal. We would argue that older people's housing should be given 'enhanced planning' status – placing it on a par with affordable housing and granting it special treatment, and privileges in the planning system. For example, such property would be made exempt from paying the Section 106 surcharge that new developments are usually liable for. This simple measure – especially if taken in tandem with a strategic review by DCLG of what other planning changes could be made to help – could help to reduce planning barriers, make these developments more attractive to funders and builders and begin to increase supply. An older population who are able to realise their wealth by moving to smaller, more suitable accommodation would be more resilient and less reliant on the state whilst giving more young people the opportunity to own their own home. This could be a financial resilience intervention that also alleviates intergenerational inequality – a real win-win.

New, national nudges

Government should build on the success of auto-enrolment and use the platform it has created to encourage innovation from financial services providers in products designed to promote resilience. These could include new, mass-market income protection schemes, employer matched savings and new critical health and life insurance products.

It is clear that the painstakingly-built political consensus around auto-enrolment has the potential to survive and to thrive. Participants in our roundtable – from a range of sectors and political backgrounds – were enthused by its success and its blend of state regulation, personal autonomy and guided choice. The unexpectedly low level of withdrawal from the scheme demonstrate the potential for the mass appeal of products that are state backed but represent a three-way partnership between the individual, their employer and a financial services provider. The mass market that auto-enrolment provides financial services with instant access to also holds the promise of innovation to both simplify and reduce the costs of products by pooling the risk and extending the reach. This should excite policy makers looking for ways in which Government can act to promote financial resilience without spending significant additional amounts of taxpayers' money.

In order to identify the next steps for auto-enrolment, Government should bring together a commission of experts to recommend appropriate new products for the platform. These should be judged on their potential to improve financial resilience, the benefit to the consumer likely to be generated by exposing the product to a new, mass market and the benefit to the taxpayer of reducing dependency and fragility. The commission should look a lot like our roundtable – bringing together representatives of Government, industry, financial services providers and charities.

Stress-testing entitlements

The Office of Budget Responsibility (OBR) should be given an expanded remit to test projections and promises around individual entitlement – from welfare to pensions – in order to give the public a clearer perspective on the risks to which they are exposed over the course of their lifetimes and the relative likelihood of current entitlements (or projections) being there to support them.

The OBR has brought much-needed clarity to macro financial projections, making it harder for Government to present to the public false narratives about the health of the country's finances and our direction of economic travel. It performs a useful and innovative function, sitting in tandem with Government and offering the public a sort of sense-check on claims that are made. This function would be useful at a more granular level – in giving us all an independent perspective on the likelihood of spending promises on personal allowances and entitlements (such as the pensions triple-lock) being sustainable in the medium to long-term. Of course, spending decisions are political decisions and neither the OBR nor any other body of economists can dictate or determine the choices future Governments will make. But an autonomous body that lays out the implications of future entitlement promises – for instance, that 'pension promise x would mean y% of GDP being spent on it by 2025' – would help to keep politicians honest about how protected we really are.

This is not about making life harder for politicians. In many ways it is the reverse. At the moment, Government is incentivised to play up the long-term security of certain entitlement spending – fearful of the political consequences. But this makes it harder both to balance the books now and to persuade the public to protect itself for the future. Outsourcing the difficult and unpalatable truths – to the OBR or to some such body – would allow our political class to present an agenda that helps individuals to take more responsibility for their long-term resilience as a solution to a widely acknowledged problem rather than as the product of governmental stinginess.

FINANCIAL RESILIENCE MATTERS

Financial resilience – the ability of individuals and families to weather financial shocks – is central to economic and emotional wellbeing. At the individual level, it dictates our capacity to engage productively in society and impacts upon our mental health. At the family level, there is abundant evidence that young people's life chances are dramatically affected by the financial resilience of their parents. But it matters, objectively, to the state too. Without a financially resilient population – capable of self-reliance and equipped with tools to help in times of financial shock – the risk leveraged against the Exchequer becomes unmanageably large. Government is left with an unpalatable choice between allowing people to be driven into sudden destitution – with economic, social and political consequences – or seeking to expand welfare coverage to encompass a broader range of events – politically and economically difficult at a time of continued fiscal restraint and where even current levels of social security are seen as unaffordable by some.

It is worth, for a moment, reflecting on the scale of the problem here in the UK. Almost 2 million UK adults are currently unemployed and – for those in work – more precarious forms of employment are more and more common; over 8 million people work part-time and almost 5 million describe themselves as self-employed.[7] Of course, many people choose to work part-time or become self-employed but for many this has a real and negative impact on financial resilience. Almost 25 million working days are lost to sickness in the UK every year and the single biggest cause of time-off is mental health problems.[8] This can have a dramatic financial impact on affected individuals and families – at less than £90 per week, statutory sick pay is far below average full-time earnings (around £400 net, after tax). Analysis from Macmillan Cancer Support suggests that 83% of those diagnosed with cancer suffer a net loss of around £570 a month over the course of their illness.[9] Meanwhile the cost of happier events – such as having a baby, getting married or choosing to return to university – have all risen sharply in recent years. At the same time, saving in the UK remains stubbornly low; the savings ratio is at a record low of just 3.8% and the average contribution rate to private sector pensions is declining.[10]

The themes identified in this paper – and the next steps that we propose – are intended as practical and pragmatic responses to this problem. They will not solve Britain's lack of financial resilience on their own, nor would they do so over-night. But they do, we believe, represent the starting point for an approach that is capable of winning political consensus and of starting to address financial vulnerability without too heavy a burden being placed on individuals or on the state. In doing so, we can help to forge a population that is more financially robust, more self-reliant and autonomous and therefore healthier, happier and freer.

NOTES

[1] Margo J 2010, Wealth of Opportunity, Demos

[2] Wind-Cowie M 2013, Squaring the Circle, Demos

[3] **https://fullfact.org/news/how-much-do-pensioners-benefits-cost/**, May 2016

[4] **http://www.thisismoney.co.uk/money/mortgageshome/article-3184763/Young-homebuyers-st.html**, May 2016

[5] Demos L&G roundtable participant, May 2016.

[6] Wood C 2013, Top of the Ladder, Demos

[7] **https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment**, May 2016

[8] **http://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/articles/sicknessabsenceinthelabourmarket/2014-02-25**, May 2016

[9] Wind-Cowie M Salter J 2013, Paying the Price, Demos

[10] **http://www.telegraph.co.uk/news/2016/03/31/ticking-time-bomb-as-household-saving-slumps-to-record-low/**. More background: **http://themoneycharity.org.uk/households-saving-ratio-lower-time-since-credit-crunch/**

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Supported by Legal & General, the paper brings together expert views from politics, business, academia and the charity sector, arguing that too many families are currently inadequately equipped to respond to unexpected changes in earnings, such as sudden job loss or illness, nor to transition between major life stages carrying new financial demands, like parenthood or retirement.