Cost of resilience

How our psychology changes how we approach our finances
Foreword from Rose St Louis of Zurich UK

The number of people who are financially vulnerable is on the rise. The Financial Lives Report from the Financial Conduct Authority (FCA) stated that more than half of UK adults show one or more signs of potential financial vulnerability – in that they would suffer exceptionally if something were to go wrong.

A recent House of Lords committee revealed that 40% of the working-age population hold less than £100 in savings. Many households are struggling with a combination of rising household costs, low interest rates, high inflation and falling wages.

In addition, although UK unemployment is falling, the number of people unable to work and taking time off due to sickness is high. An estimated 131 million working days were lost due to sickness or injury in the UK in 2017. Furthermore, over half of UK adults have had to take unplanned leave from work or have been in between jobs, with one in ten (10%) not being in work for 12-18 months. One in five (20%) have been out of work for up to a month and well over two in five (45%) for up to a year.

A lack of savings and job security is putting millions of adults at risk of not being financially resilient – they would face difficulty in overcoming a financial shock or loss of income. Not only will this further dent an individual’s financial ability, but the stress and worry can potentially lead to mental and physical health issues.

It’s not just the impact to the individual that’s a concern, but the implications to their loved ones, including their children and partner.

Despite this, nine in ten do not consider protecting themselves with financial products such as Income Protection – which replaces monthly income if an individual was involved in an accident or became too sick to work. Our findings show that people are more likely to spend on insurance for belongings rather than their income.

More work is needed to encourage people to review their circumstances and consider the steps they can take to protect themselves. The Cost of Resilience report has been commissioned to explore financial resilience and understand the role financial products can play.

Foreword from Dr Jack Lewis, Neuroscientist

We have a tendency to prefer items that we can enjoy immediately over and above more valuable things that we have to wait for, even when the latter add greater value to our lives overall. When it comes to managing our finances, such inclinations are very unhelpful.

Several of the findings in this study show all the hallmarks of a psychological phenomenon known as the ‘availability heuristic’. One aspect of this is the tendency to feel a stronger perception of risk when we can quickly bring examples to mind. The upshot is that we feel more motivated to protect ourselves against whichever risks are perceived to be greatest, whether they really are or not.

A classic example involves asking people, ‘which poses the greatest danger: nuclear power or sunbathing?’ The knee jerk reaction is to say ‘nuclear power’, because people quickly bring to mind examples of nuclear power stations around the world exploding. The truth is that skin cancer caused by sunbathing kills considerably more people annually than nuclear power accidents.

Most people struggle to bring to mind examples of skin cancer victims, yet easily think of dramatic nuclear plant meltdowns from around the world, their perception of the actual risks are back to front.

Applying the ‘availability heuristic’ to this study can shed light on some of the results. It’s easy to bring to mind occasions when ourselves, friends or family might have benefited from having insurance when suffering a prang, leak or flight cancellation. As examples of situations where car, home and holiday insurance can come to the rescue are so available, our perception of risk in these areas is high, so we’re highly motivated to protect ourselves. Examples of income protection saving the day generally don’t pop into our heads so readily. The perception of risk is lower, the benefits associated with income protection broadly overlooked and so people tend not to be highly motivated to invest in it.

This Cost of Resilience report shines a much-needed light on an important topic. Although there is plenty of academic research indicating that a period of unemployment can have many negative impacts, this type of study – looking at how well or poorly British people are financially positioned to cope with unanticipated unemployment – has not been conducted before.

A financial product that pays your salary when you are too ill to work is a strange and perhaps counter-intuitive concept. We need to educate people to help them understand that such support exists; products that ease the stress and anxiety stemming from the threat of an unanticipated loss of income, as well as protecting against the potential physical and mental health repercussions to the individual, and their family, if this actually came to pass.

What is financial resilience?

Many of us don’t think we’ll ever experience a financial shock; whether that’s the boiler breaking down, an unexpected bill, or having to take extended time off work due to sickness. To be financially resilient is to be able to recover quickly from unexpected financial situations such as these.

To understand the issues surrounding financial resilience, Zurich has partnered with Neuroscientist Dr Jack Lewis. The research found that one in three (34%) people in the UK do not feel financially resilient; this is the equivalent to more than 17.6 million adults across the country who are at risk of failing to recover from a financial shock or loss of income.

One in six (17%) adults say that they have no disposable income and almost a quarter (24%) have no savings. As a result of having no financial safety net, many adults are not in a position to recover from a potential financial shock. Combined with the risk of having to take time off due to illness or injury many would struggle significantly.

The academic view

“All humans suffer from a phenomenon known in scientific literature as ‘temporal discounting’. This boils down to our tendency to value the immediate and tangible over and above things that we have to wait for; even when those things have the potential to offer much greater value overall. This ‘temporal discounting’ effect can be seen in action in neuroeconomic studies where people’s brains are scanned while they make financial decisions. The ventral striatum is part of the brain that assigns value to each option, so is instrumental to decision making in terms of determining what is deemed the best choice. This is the core hub in the reward pathway – and its activations are usually stronger for an immediate reward over a slightly larger reward that is only accessible after a delay. This impatience, inherent in the very fabric of our brains, can account for why people don’t put enough money into savings. Typically, any money that could have been squirrelled away into savings will instead be spent on events, gadgets, holidays and other short-term pleasures that can be enjoyed quickly without having to exercise too much patience. But, when it comes to Income Protection the low uptake goes further than just ‘temporal discounting’ – with many people choosing to ignore the risks they’re faced with.”

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4 https://www.ons.gov.uk/aboutus/transparencyandgovernance/freedomofinformationfoi/ukadultpopulation
What is the impact of not being financially resilient?

There is no doubt that not feeling financially resilient can cause significant harm to an individual. Three in five (60%) adults say a financial shock would negatively affect their mental wellbeing, and of these, almost a quarter (23%) say it would impact it greatly.

Of those that told us that they do not feel financially resilient, two in five (43%) state they don’t feel in control of their life, while more than two fifths (41%) do not feel positive about their future.

Even prior to a financial shock taking place, adults are often concerned and lose sleep. Our study found that more than eight in ten (84%) find themselves waking up at night worrying, and of those, a fifth (19%) wake up more than once a week. Those who say they aren’t financially resilient are more than 50% more likely to wake in the middle of the night worrying – at least once a week – compared to those who describe themselves as financially resilient (36% vs. 55%).

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The academic view

“Worrying too much can negatively impact our ability to get a good night sleep, which in turn affects brain health. Sleep gives our brains the opportunity to do a variety of essential tasks. It is while we’re asleep that the vital work of consolidating memories takes place – taking the most important short-term memories and turning them into long-term memories. Another vital sleep function involves taking the emotional sting out of unpleasant experiences. Sleep is also when much needed maintenance and repair work takes place. Most importantly, it is when toxic metabolic waste materials are removed. If people regularly wake up in the night, then all of these functions are compromised. In the long run this is bad news for the brain.”

Overall, health and money worries are the main concerns for adults who tend to worry at night, ranging from salary concerns to debt and not being able to support dependents. One in five worry (19%) that their money won’t last until next payday, while one in seven (17%) are concerned about their debt and one in ten (10%) UK workers worry that their income won’t support them or their dependents in the long-term.

“Chronic stress is potentially damaging to a person’s health even if it doesn’t affect their sleep. The stress hormone cortisol is released into the bloodstream and travels around body and brain to help release the extra energy and resources that help us to deal with the stress. Constantly worrying about finances means having chronically elevated cortisol levels, which gradually wears us down. In extreme cases, it can actually remodel certain brain areas.”

More women than men say they wake up at night concerned (89% vs. 78%). Those aged under 25 are the least likely to worry due to worrying, while those aged 55+ are the most likely age group to find themselves worrying during the night and waking up (18-24 (71%), 25-34 (80%), 35-44 (87%), 45-54 (83%), 55+ (88%). Four in five (85%) parents say they wake up at night worrying, of which a fifth (21%) say they wake up more than once a week.

Not having protection and insurance products in place appears to be positively correlated with the incidence of worrying. Of those who state they wake up at night with things on their mind, two-thirds (66%) do not have income protection in place, compared to one in twenty (5%) of those who do have it. Three in five (60%) of those who wake up worrying don’t have critical illness cover while two in five (43%) don’t have life insurance.
There is a clear relationship between having dependent children and not feeling financially resilient. Half (48%) of parents with children under the age of 18 say they do not feel financially resilient. More than a third (37%) of parents say they do not have any savings should something go wrong, while one in five (21%) have no disposable income. The impact is felt beyond the individual with almost half (49%) of parents admitting that experiencing a financial shock would have a negative impact on their children’s wellbeing.

The academic view

“A raft of peer-reviewed papers have accumulated over the years suggesting that one or both parents being out of work is associated with various negative outcomes for children in the household, particularly those in adolescence. These include reductions in physical and mental health, a higher occurrence of behavioural problems, poorer academic achievement and even a higher incidence of smoking. The root cause is thought to be the distress that a loss of income causes to parents, which places extra pressure on relationships and has a negative impact on parenting practices. It’s reasonable to assume that having something to fall back on, whether that’s savings or dedicated financial products designed to keep the money coming in when out of work, would reduce the stress levels in the household sufficiently to avoid some or all of these negative outcomes.”

While parents with children under 18 have many worries, the ones affecting their sleep are often money related, including how to make money last until the next time they receive money (28%), debts (27%) and their salary not being enough to support them and their dependents in the long-term (9%).
The impact of work insecurity

While unemployment is falling, recent ONS figures\(^5\) found that 1.36 million people remained unemployed between April and June 2018, which does not include those temporarily off work due to sickness. When it comes to job insecurity, our study found that more than half (53%) of UK adults said they had experienced unplanned leave from work or had been unemployed while in between jobs. For one in ten (10%), they were unemployed for 12 months or more. One in five (20%) have been out of work for up to a month and well over two in five (45%) for up to a year.

Being out of work doesn’t just impact an individual’s financial situation, but also comes with added social burdens and personal sacrifices. When asked to consider a recent time when unexpectedly out of work, nearly a quarter (23%) had to turn to family for support while one in twenty (5%) have had to take out a loan in order to make ends meet. During this time, two in five (40%) cut back on shopping for ‘nice to haves’ while one in five (22%) had to give up their social life.

To mitigate the impact of a financial shock, people would struggle to make certain sacrifices. Giving up the family home, followed by their car and family holidays would be the most difficult.

Advisors would struggle to make the following financial sacrifices if they were forced to be more careful with money:

- 51% Giving up my home
- 37% Giving up my car
- 23% Not going on a family holiday
- 23% Buy less/ no birthday/ Christmas presents
- 14% Not buying any ‘luxury’ food items
- 13% Not buying lunch when out
- 12% Giving up weekly nights out (e.g. going out for dinner, drinks etc.)
- 8% Giving up my cinema / movie subscription (e.g. Netflix)
- 7% Giving up my gym membership
- 5% Giving up my magazine subscription

Despite a significant number of adults having experienced unplanned time out of work due to illness or injury, fewer than one in ten (8%) have ever taken out income protection.

\(^5\) https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/august2018
To be financially resilient, a third (33%) said they would need to earn between £1,000 and £2,000 per month, while almost a fifth (18%) said they would need to earn between £2,000 and £4,000. According to ONS, the average UK individual take-home pay is £1,8236 meaning that adults will be earning slightly less than the amount needed to feel financially secure. This combined with people not being in a position to overcome a financial shock or loss of income – should they have to take time off work due to sickness or injury – means many would struggle significantly if disaster was to strike.

Nearly two in five (37%) also said it required them to have savings, while almost a quarter (22%) said they would need to not be in any debt and one in six (17%) said they needed a secure job.

More women than men believe having savings would make them feel most financially resilient (44% vs. 29%), while having a secure job would make more men than women feel secure (21% vs. 14%).

UK adults who feel financially resilient are more likely to have insurance for tangible assets such as a car (75%), home (71%), travel (70%) and mobile phone (17%). While more than a third (34%) said they would not be able to recover from a financial shock or loss of income, only 8% have Income Protection, a financial product that shields your pay against illness, injury or being unable to work.

**The academic view**

“We all know that accidents happen and misfortune can strike at any time, but as a general rule we prefer not to think about it. If you smash your mobile phone screen, flood the bathroom or get a big dent in your car – these are impossible to ignore because the visible evidence is plain to see. Therefore, it’s front of mind when it comes to thinking about investing in insurance to protect our possessions. Income Protection, on the other hand, is not associated with physical objects. This lack of visibility, and the fact that people tend to assume the unexpected won’t happen to them, may account for the lack of awareness that such products even exist, and even if people have heard of it, the very low numbers of people who get around to investing in it.”

**How to be financially resilient**

It is shocking that one in three adults do not feel they would be able to carry on with life as it was before a financial shock or loss of income took place. Yet, while people feel vulnerable to a financial shock and an unexpected loss of income, nine in ten do not consider how to protect themselves. Instead, they are more likely to purchase insurance for belongings, than on their income.

While Income Protection isn’t a tangible product, it’s one that could actually have the most benefit for individuals and their families. As well as the financial benefits of replacement income, rehabilitation is also available to help individuals’ access treatment and support to help them recover and get back on their feet. More has to be done to encourage people to review their circumstances and consider the support available to protect them and reduce feelings of financial vulnerability.

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6 https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/householddisposableincomeandinequality/financialyearending2017