



Resolution Foundation

Financial Health Index

Key points

1. The index will provide an annual account of the financial health of UK individuals or households as a whole. The index will be delivered annually in the third or fourth quarter of each year and will be accompanied by a thorough analysis of the data for publication by the Foundation
2. As well as the composite financial health indicator the report will include a number of individual indicators that will demonstrate change over time in separate aspects of financial health and capability
3. In order to ensure the FHI is repeatable and comparable over time, we will use only as many indicators as needed to demonstrate financial health – the index should be as slim and manageable as possible

The purpose of the index

To provide a clear statistical estimate of the financial position of individuals or households in the UK

To show the changing financial health of UK individuals or households over time

To compare the financial health of different types of individuals or households, specifically low earners

To provide the Foundation with an annual output that can be used to inform our own work and also generate wider debate

What is financial health?

For our purposes, *Financial Health* describes the financial well-being of an individual and households. Good financial health depends on positive financial choices as well as the absence of financial difficulty. It is influenced by such factors as environment, lifestyle, availability of financial services and personal choice

What would a financially healthy person look like?

Background research and previous Foundation work suggests that a financially healthy person would:

- Be engaged with the financial system
- Have some resilience to unexpected financial shocks
- Be capable of managing their day to day finances
- Seek advice on financial matters
- Plan for the future
- Have a manageable level of debt

Proposed indicators

Engagement with the financial system

- Holds and uses a bank account
- Covered by life, possessions, or mortgage insurance
- Access to affordable credit

Resilience to unexpected financial shocks

- Covered by life, possessions, or mortgage insurance
- Saves a proportion of income

Capable of managing their day to day finances

- Saves a proportion of income
- Disposable income after housing costs
- Proportion of income spent on interest payments

Proposed indicators

Seeking advice

- Proportion that have sought advice in the last (...) months

Plans for the future

- Holds a personal private or occupational pension

Has a manageable level of debt

- Proportion of income spent on interest payments

Proposed indicators – rationale

Holds and uses a bank account

Numerous benefits to having a bank account: they act as a gateway into other services; most employers prefer to pay wages into a bank account; money is safer in an account than kept in cash; consumers save money i.e. companies incentivize paying bills via direct debit.

Covered by life, possessions, or mortgage insurance

Being prepared for the worst ensures that if the worst does happen, the consumer will not be financially devastated. It also shows an understanding of the importance of planning ahead.

Access to affordable credit

Having access to credit can smooth the 'peaks and troughs' of unexpected expenses. Without access to affordable credit consumers will turn to more expensive sources such as doorstep lenders or worse, illegal money lenders

Proposed indicators – rationale

Saves a proportion of income

Adequate savings ensure that consumers can deal with unexpected expenses and also decrease their need for credit thus saving them money in the long-term

Disposable income after housing costs

Net disposable income after housing costs (as is used for pensioner poverty) reflects tax, benefits and equalises renters and homeowners

Proportion of income spent on interest payments

While a certain level of debt can be expected, high levels or widespread debt can be an indication of poor financial health. The proportion of an individuals' income spent on interest payments is an indication of the manageability of that debt

Proposed indicators – rationale

Proportion that have sought financial advice in the last (...) months

Seeking financial advice is a measure of financial capability, it indicates that people recognise the need for assistance in financial matters and know at least one place to find that advice

Holds a personal private or occupational pension

Planning for retirement indicates an understanding of the importance of planning for tomorrow and not just living for today. It is vital as the State Pension is not enough for most people

Further considerations

The list of proposed indicators is designed to be sufficient but not comprehensive. There are many publications that have provided rich in-depth analysis of some of these issues (including the FSA Financial Capability Survey and the newly-released Wealth and Assets Survey). Many of those studies are large-scale one-off pieces of work or are not intended to be delivered on a frequent basis.

The Foundation's Financial Health Index is intended to be released annually. We therefore need to use indicators that will be available each year, which limits the data sources that we can draw on – good examples are the British Household Panel Survey and the Family Resources Survey which are updated annually.

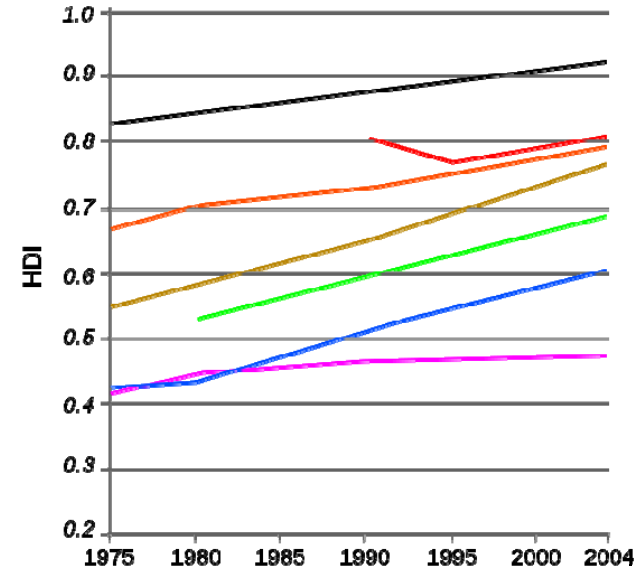
The selection of indicators was therefore predicated on the availability of regularly updated secondary data together with limited investment in other indicators that are deemed to be necessary but which are not currently available from other sources.

How will it look? An example using another index

The intention is to combine the above indicators into a single statistic that will illustrate the financial health of individuals or households in the UK and how this changes over time. To do this we need to make the data “value-free” so that each indicator is on the same scale. The method used by the UN’s Human Development Index puts each of its indicators on a scale between 0 and 1. While this may not show us too much in the first year, over time the year-on-year variation in financial health should become apparent.

The Human Development Index

The HDI is derived from three indicators: longevity (measured by life expectancy), educational attainment (adult literacy and a combined enrolment ratio), and standard of living (GDP per capita). Each of these variables is re-scaled to give a value between 0 and 1 and is then combined to give each country a single Human Development score for the year.



Changes in HDI for seven groups of countries

Output

We intend to publish the Index in the third or fourth quarter of each year. As well as the overall financial health indicator there will be an accompanying report that analyses the direction of travel for each of the individual indicators and the reasons for any change.

The index report will also be complimented by the qualitative research that the Foundation is currently conducting which examines the reasons for changes in financial health and circumstances and the effects of these on people's lives. We will also use this work to examine gender roles in financial health which will build on some of the findings from our initial analysis of the qualitative data.

Possible developments of the Index

There are further analyses that could be taken from the Index which could prove to be more insightful than simply measuring change over time:

1. An objective standard of financial health could be derived. Using this we could measure how far the UK population varies from the “average”
2. Building on previous Foundation work, categories of financial health could be outlined and the position of the UK population in relation to each of these could be presented

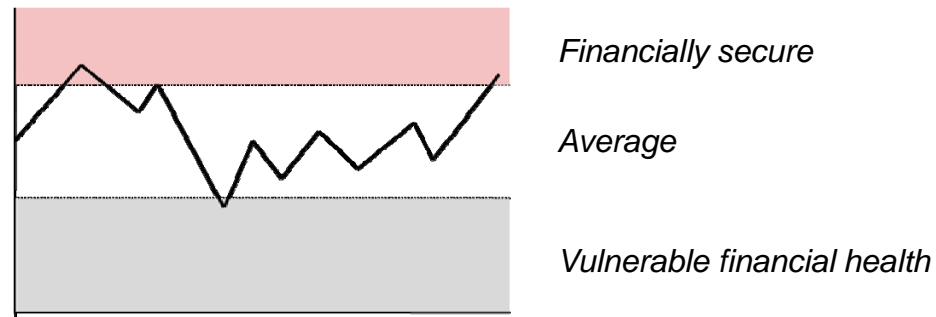


Illustration of zones of financial health

3. The financial health indicator can be used as variable in future analyses so that we can examine the correlates of financial health
4. Qualitative analysis will compliment the Index so that we can assess what is going on beneath the headline statistics. Different themes can be analysed in each edition of the report e.g. The role of gender, resilience to changing financial circumstances, hidden assets and liabilities.

Discussion

Are the chosen indicators appropriate and sufficient to give an accurate impression of individuals' financial health or are there any key areas that have been overlooked?

Thanks

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