M4MONEY

JOURNEY TOWARDS FINANCIAL BLISS

Basics of “Emergency Fund”

An **emergency fund** is a stash of money set aside to cover the financial surprises life throws your way. These unexpected events can be stressful and costly.

We don’t have to re-invent the wheel by defining what is “emergency”. Everyone understands it. In simple words, it is occurrence of an unexpected event with adverse impact on our otherwise smooth life. Such event could be a severe accident, sudden death, unexpected serious illness, physical disability, loss of job with resultant financial uncertainty. When life presents an emergency, it threatens our financial well-being and causes stress. Any of these can stretch the generosity and finances of families. Each of us will tackle such ‘emergency’ in his / her own way and will definitely tide over it with passage of time. May be, sometime one just reconcile to a certain kind of ‘emergency’ which comes as ‘fait accompali’.

Nevertheless, it is always prudent to be in readiness, to the extent possible, even for those uncertain events, severity and timing of which we are not able to gauge or assess accurately. In ‘emergency’ situation, our readiness and ability to address it at least in the initial phase, gives us a lot of confidence towards its ultimate resolution.

When life throws nasty financial surprises your way, have a Plan B ready. An adequate emergency fund can help you tide over the crisis. That is the contingency fund we may have to build for our own happiness

Now find out how big a contingency fund should you have. This question will have to be answered by each one of us in our own way, though there are broad criteria. In today's uncertain job market, a lay off can lead to months of unemployment. But anyone with a stable and secured job need not worry too much on this count. On the other hand, Stars, artists and sportspeople typically have very short career spans and irregular income levels and thus would need to factor these to work out the quantum of emergency fund as well as in their overall financial planning. Similarly, one would need to take into account the quantum of EMIs for existing debt servicing as well Insurance premium already contracted. Besides, if there are certain known regular medical expenses (for an existing chronic illness of any family member). Lastly, the number of earning members in one's family as also the number of dependent family members and overall household expense, will all determine the extent of emergency fund which anyone would need to keep aside.

The thumb rule is to keep aside 3 to 6 months of basic life expense and payments. It is generally experienced that during this period of an emergency situation, a viable alternative is worked out to bring the life back on rails.

In today's time where health insurance plans are becoming quite popular, need of an emergency fund for medical emergency is diminishing. But at the same time, health insurance is actually available only when hospitalisation is needed. So one will need cash for doctor visits, tests and medicines, prior to hospitalisation. And cost of these diagnostic tests, sometime, could also be substantial. Some health insurers have started insurance policies for OPD expenses also but one should be careful in weighing the pros and cons of these vis a vis return in liquid funds, as these health plans are currently priced at high premium.

Similarly, credit cards have also reduced the need for emergency funds, as expenses can be paid almost instantly through credit cards. Credit cards will make us available interest free funds for period up to 50 days, during which alternatives sources of funds could be tapped and credit card bill paid. However, credit cards should not be seen as a replacement for setting up an emergency fund as these funds would be exorbitantly costly, beyond the initial period of 50 days.

Once the size of this kitty has been worked out, the next question to be addressed is where to invest these funds, without compromising on the key element i..e ‘access and easy availability of these funds at short notice. Remember, ‘return’ on these funds is of secondary importance.

No financial planner will suggest to keep emergency funds idle. One should look for options for investing these funds also. One can park at least 25% of the emergency fund in saving bank account, which can be withdrawn 24*7. Here, ensure you have a debit card with adequate cash withdrawal limit. Many people remain unaware of their debit card’s daily cash withdrawal limit till the time they attempt to withdraw huge amounts of cash during an emergency.

Keeping aside cash for a rainy day

The money can be kept in multiple places, but should be easily accessible.

Investment option	SAVINGS BANK ACCOUNT	SWEEP-IN BANK ACCOUNT	FIXED AND RECURRING DEPOSIT	LIQUID FUNDS	SHORT-TERM DEBT FUNDS
Returns	4-6%	7-8%	7-8%	8-8.5%	8-9%
What's good	Easy to operate and everybody has one.	As liquid as savings account but earns more.	Easy to open and break at short notice.	Higher returns, fast withdrawals via ATM.	Higher returns and ease of withdrawal.
What's not	Earns low interest; too easy for comfort.	Again, easy access can be a problem.	May require bank visit if there is no online access.	If no ATM facility, money reaches bank in 1 day.	Money reaches your bank in 1-2 working days.

But savings bank accounts give very low interest of 4% p.a. on the balance (with exception of few private sectors banks now, where it can go up to 6%). A more remunerative option would be a sweep-in account where excess funds automatically gets converted into a fixed deposit with higher returns of 6-8%. When you withdraw, the money is paid by breaking the fixed deposits.

The other comfortable option is to park these funds in liquid fund scheme. The money will earn a decent return and can be withdrawn at any time. Liquid funds and some ultra-short funds have returned more than 8% over the last one year. Redemption under these schemes takes a day only. Some fund house offer liquid funds that come with ATM cards so the investor can withdraw the money directly without the redemption first going to his bank account.

Revisit your emergency fund kitty regularly review it at least once a year. A contingency kitty once formed is not the end of the process. Everyone needs to revisit this fund and replenish it regularly to adjust for inflation, lifestyle changes, increase in family members and changes in debt commitments.

Creating Emergency Fund is the first step of a Financing Plan.

- ✓ ***It helps keep your stress level down***
- ✓ ***It keeps you checked from spending on a whim.***
- ✓ ***It keeps you away from making bad financial decisions.***

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