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Business

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Contingency fund will help one manage emergencies, as the person need not worry about meeting household expenses or repaying loans for a few months. (Shutterstock)

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The current pandemic has led to unexpected job losses or pay cuts for many and it has brought in a lot of financial uncertainty in lives of a large section of the population. Many are struggling to pay their credit card bills, EMI's and other loans. Though some banks are offering a complete moratorium on all loan repayments, it is not easy to find a new job within months and regain financial stability. Apart from loans, the biggest challenge at present for those who lost jobs (or faced salary cuts) is to find ways to run a household, not to forget deal with health emergencies.

It is for this reason, financial planners have always been insisting on building a contingency fund. However, only recently in this current pandemic, people have started realising the fund's potential.

"Contingency fund, as the name suggests, is the fund which sails you through financially, in case of any turbulent time for a short span. So, it is not a fund, which can support you for long, but acts as a cushion for any unforeseen circumstances that have the potential to hit you financially like temporary job loss or furloughs," says Mumbai-based financial expert Nishant Kohli, founder and director of Mudra Portfolio Managers.

Emergency Fund is not to be utilised for regular expenses or for discretionary purchases. It's not a buffer to dip into if you are running low on funds for purchasing non-essential things. It is solely for tackling emergencies and is your Plan-B for hard times, says investment advisor and founder of StableInvestor Dev Ashish.

The contingency fund will help one manage emergencies, as the person need not worry about meeting household expenses or repaying loans for a few months.

Financial experts say that it is advisable to have 6 times of one's monthly income as a contingency fund. And that 30% of it should be parked in sweep-in FDs and the balance in ultra-low duration debt fund, which have better yield than liquid funds as the yields of liquid funds have come down lately.

"Funds in FDs will provide for corpus/money in case of immediate need. However, an early withdrawal can attract penalty, and the investments in ultra-low duration debt funds can provide you good returns and are fairly liquid," informs Kohli. For instance, if a person's take home is Rs 75,000 per month, the contingency fund should be around Rs 4.50 lakh.

However, if the corpus is less than 6 times of the salary and the savings are less, the emergency fund can be created in phases. Phase 1 should be 6 times of your monthly expenses. For instance, if someone is earning Rs 75,000 per month and has an expense of Rs 50,000 per month, then the first benchmark would be to create a contingency fund of Rs 3 lakh and then the person can aim to take this to Rs 4.50 lakh in due course of time, says Kohli.

For those who do not have anything saved, Ashish says build it gradually using monthly savings. If need be, cut down on discretionary spending for some time and use the money to shore up your emergency reserves, he adds.

"These days, many feel that if they have credit cards with large limits, then they can skip having a dedicated fund for emergencies. No doubt that a credit card can come in handy in emergencies. But it's important to understand that credit card cannot be a replacement for an emergency fund. A credit card can only delay the use of your emergency fund. You can use a card to tide over the emergency in the short term. But eventually, the money will have to be paid back when card outstanding becomes due. So card or no card, the buffer is required," says Ashish.

Can one use emergency fund to pay for health emergencies? Yes, say financial advisors, but suggest taking health insurance as it covers the risk of health-related expenses.

"If someone has elderly parents who are dependent on them and they do not have sufficiently large health insurance covers, then such people should also consider keeping large emergency funds to have a buffer for uninsured, in-home medical expenses for parents," says Ashish.

Contingency fund has been often ignored by a large section of the population. But this Covid-19 pandemic and ensuing economic turmoil has taught a lesson to most of the people to create a contingency fund so that one can be prepared for a rainy day.

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