BUSINESS

Why Covid-19 pandemic has put the spotlight on contingency funds

Financial experts say that it is advisable to have 6 times of one's monthly income as a contingency fund.

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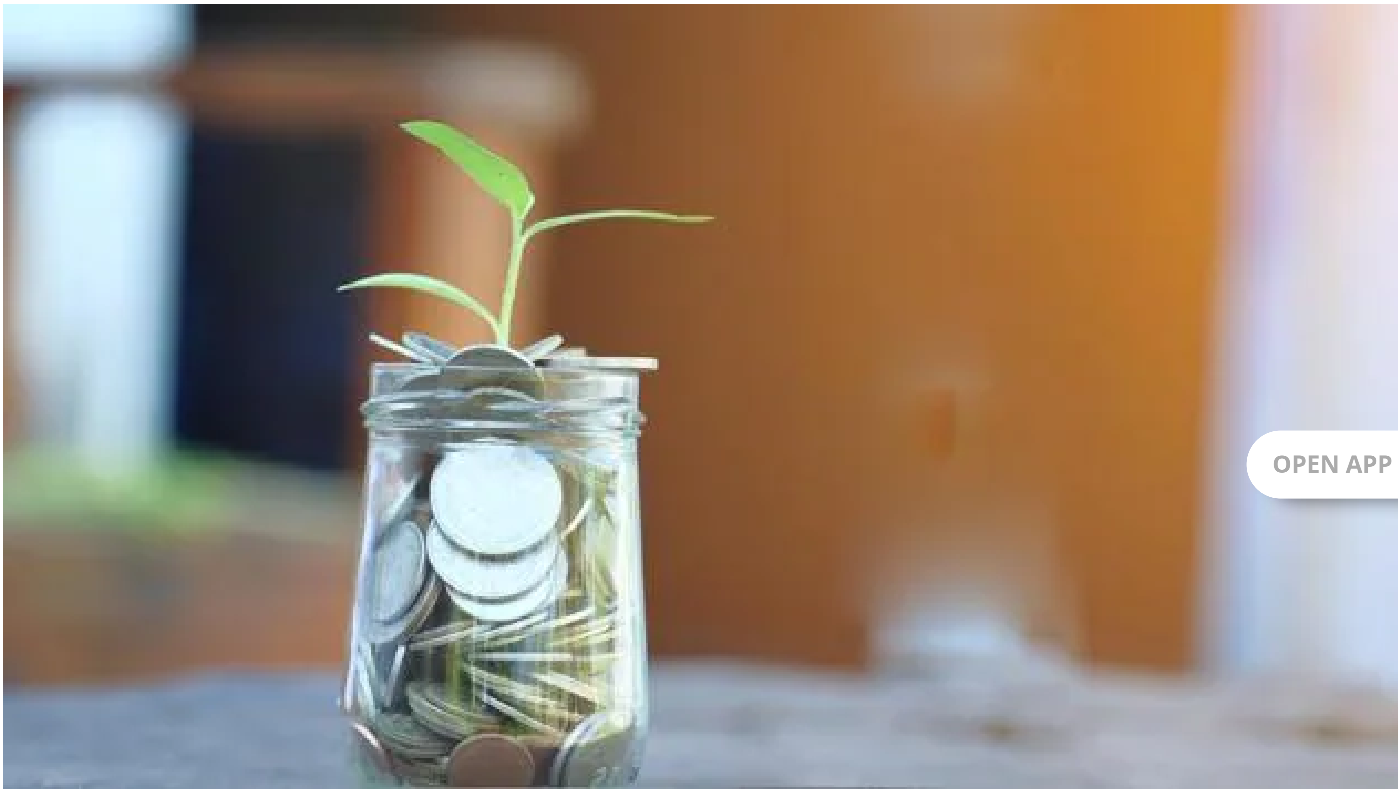

Contingency fund will help one manage emergencies, as the person need not worry about meeting household expenses or repaying loans for a few months. (Shutterstock)

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, EMIs and other loans. Though some banks are offering a complete

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

“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.