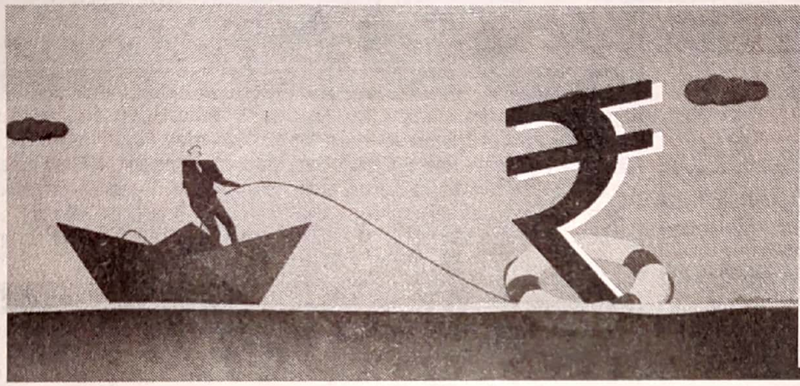
Maintain an emergency fund, always

If there are more dependants, it is important to have a significantly large amount

SARBAJEET K SEN



FOR A RAINY DAY

Instrument	Returns (%)
Savings bank account	4.0-6.0
Sweep-in FD	6.5-7.0
FD	6.8-8.0*
liquid funds	6.9-7.6#

*1-year FD rates, Minimum is past one year return of the entire category, Max return is 10-year category average of liquid funds, Source: Banks and Value Research

Vikas Singh, 28, had a cushy job with an airline and earned a good pay packet. Things were going rather well for him for over two years until the airline ran into rough weather. Facing financial troubles, the airline began curtailing operations, leading to layoffs. And Singh was one of the unfortunate ones handed over the pink slip by the management.

A happy-go-lucky person, Singh had never saved for the future. Within days of being retrenched, Singh was struggling to pay his expenses as his bank balance was drying up. Singh is not alone. There are many similar cases. For example: Many employees of the almost-defunct Jet Airways have not been paid for months, and many findthemselves in deep financial trouble today.

According to financial planners, Singh's main mistake was not creating an emergency fund at the start of his career. In fact, some financial planners believe creating an emergency fund should take precedence over other investments when you start financial planning.

YOUR MONEY

"Emergency fund should take precedence over other investments, especially for someone who is at the start of his career with no savings. Setting up this fund should be top priority," says Milin Shah, head – product development and planning at HappynessFactory.in.

Size of the kitty: The amount of money you should have as your emergency fund would vary from person to person, depending on the family and financial situation. Vishal Dhawan, founder and CEO, Plan Ahead Wealth Advisors says that one's expenses should ideally determine the size of the corpus. "Instead of using income as the parameter, it is better to determine this based on one's monthly expenses. Ideally, for single-income families, creating a corpus that would meet six months of expenses is recommended. For double-income families, this could be three months of expenses, and for entrepreneurs/business owners/self-employed professionals it should ideally be 12 months of expenses," says Dhawan. Thus, if a family with a sole earning person has a monthly expense of ₹50,000, the emergency fund should be around ₹3 lakh.

Where to park this money: Ideally, most of your savings, including the amount lying in an emergency fund, should never be left idle. The money should be parked in various instruments to earn returns. However, since the emergency fund is for a dedicated purpose, it should be treated differently and put in instruments that provide high liquidity. "The focus should be on liquidity and safety rather than returns and the objective should be to manage an emergency rather than earn more. There are different options to park the emergency corpus. Short-term bank fixed deposits, and liquid mutual funds are the best options available to park the emergency fund. The return expectation from such options should be 5.5-6 per cent a year. Ideally, nothing more than the required amount should be parked in such instruments. Any excess amount should be invested for higher returns based on your financial goal requirements," says Shah.

Dhawan suggests that a portion of the corpus can be kept as cash. "A small portion of the money should be in cash to tide over situations such as natural calamities, which may cause electronic services to suffer and credit cards/debit cards/ATMs becoming unavailable. The rest can be parked in a combination of flexible fixed deposits linked to the savings account and overnight mutual funds," he said.