

Financial Planning Matters:

Creating and Funding an Emergency Fund

By Julie Cole, CFP®, FLMI, Annuity Product Manager



We live in a debt-filled society. According to the Federal Reserve, 44% of U.S. families spend more money than they earn and 71% of families live from paycheck to paycheck.

Year-to-year personal bankruptcy filings were up 58% in 2008 and 70% in 2009. Forty-six percent of personal bankruptcy filings in 2008 were the result of job loss and 48% were a result of disabilities that led to loss of income. About 4% of bankruptcies are due to uninsured family medical expenses and the remainder from poor financial management.

While it is very difficult to predict a layoff, other than knowing 1 in 20 workers each year lose their jobs because of factors they cannot control, we do know that disabilities resulting in loss of income are predictable.

Take note of these disability statistics: 1 in 7 workers entering the workforce in 2010 can expect to become disabled for 5 years or more before they reach age 62. Ninety percent of these disabilities are not related to the work they perform, but will be a result of lifestyle choices and family genetics. Currently, 18% of the U.S. population, roughly 50 million people, under the age of 65 consider themselves disabled, but only 40% of these have been approved for Social Security Disability Insurance (SSDI). Seventy percent of the workforce does not have disability insurance. Yet, most of us can purchase disability insurance at an early age at a very low monthly premium cost.

All workers can fund an emergency fund. An emergency fund should be the highest priority of all of your savings. Putting money in a savings account that earns a low-return is a good thing, if the money is designated for emergencies.

There is no magic number about how large an emergency fund should be, but it should be no less than an amount equal to 6 months of household fixed expenses, if you have a private long-term disability insurance policy. Six-months is the typical exclusion period on private disability contracts. If you do not have private disability insurance, then you should have a larger emergency fund since it will likely take longer to apply for and get approved for SSDI. Your profession will influence the amount needed in your emergency fund. If you are in a profession that experiences frequent downturns that last for extended periods such as the building industry, you may want to have 1 year of fixed expenses saved in an emergency fund. Those employed in a declining or mature industry may need to assess the likelihood of a layoff. As an example: If you are a switchboard operator, and you can be replaced with an electronic answering and call routing system, then you should plan on a larger emergency fund.

Setting up an emergency fund seems simple to do, but the old adage “Failing to plan is planning to fail”, comes into play. Cutting discretionary spending is the place to start. Making reductions in spending in restaurants, new cars, the latest in electronics, vacations, daily coffee and snacks and books and publications can save you hundreds of dollars per month. Selling those unused and unwanted things around the house can yield a lot of cash, too.

Bottom line. Funding an emergency fund will give you a sense of freedom and reduce stress in your life. Peace and prosperity is a result of sacrifice and planning for the inevitable financial pitfalls that all families will experience sometime. Planning for “bad” times is a “good” thing.

