CONSULT THE EXPERTS

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I am a 25-year-old male and a working professional for the past three years. I already have a whole life policy that my dad bought on my behalf when I was young. I have some extra disposable income right now and am wondering if I should increase my insurance coverage since I am young and premiums are cheaper. At the same time, I don't want to burden myself with liabilities that might not be relevant to my age at this time. Should I do that, or should I wait to buy one that will match the milestones in my life when I am older?

> Eddie Wong, Petaling Jaya

Lim Yan Chang,
Managing director and licensed financial planner,
Wings Alliance Sdn Bhd

A As a young professional, you have a lot going for you in the future — provided that you plan and plant your goals right. Before considering whether to increase coverage, you should first review the current coverage — the amount and type of policy as well as your current income. Also consider any liabilities like education loans, car loans and property mortgages, even if jointly held. Are there any dependents, such as your parents who may suffer financial loss in the event of your death, disablement or critical illness? Your independence, not having to rely on your parents, means you have to bear your responsibilities yourself. The intended coverage should remove such financial responsibilities from your parents or those who supported you.

Consider these three questions to help you answer your insurance needs:

1. Why do I need insurance?
2. How much would I need?
3. What type of insurance should I invest in?

NEEDS AND INTENTIONS

Insurance needs typically include coverage for death, disablement and critical illness. (While some insurance policies do have cash value, thus providing some retirement funds, it is best to consider this separately together with investments). The intention is to provide a lump sum of money to overcome any financial afflictions arising from any unwelcome events. As you are still young and may not have built up sufficient reserves, insurance is the simplest, most economical and surest way to create the funds needed. This will effectively relieve the family's financial burden, especially in the event of disablement or critical illness.

HOW MUCH?

Commonly, there are two ways to determine the amount of coverage required — income replacement and capitalisation of economic life value.

Income replacement is based on the current income required to be replaced over a period of time. Thus, if the current income is RM60,000 per annum required to be replaced over 10 years, the insurance coverage required is RM60,000 x 10 = RM600,000 less existing coverage.

Additionally, you may consider increasing the amount by a factor to allow for increasing income as well as inflation. Admittedly, this is not the most accurate method but a rule of thumb to give you an idea of the amount of insurance to invest in. This method assumes that you or your dependents will be able to provide for yourself or themselves after 10 years.

Capitalisation of economic life value is the concept of creating capital that will replace the current income continuously. Thus, if the current income is RM60,000 per annum and the return on investment (ROI) is 4% (based on passive income through the bank), the coverage required is

$$\frac{\text{Current income} \times \text{factor (for example, 0.8)}}{\text{ROI}}$$

$$= \frac{\text{RM60,000} \times 0.8}{4\%} = \text{RM1.2 million}$$

The factor is to allow for the reduction of expenses such as work-related transport, entertainment and travel, income tax and so on. If there are loans and other liabilities, additional coverage may be included. While this not an exact science, an in-depth discussion with a financial adviser or coach will help you arrive at a more suitable coverage.

TYPE OF INSURANCE

The type of insurance will depend on the cover. As the key intention is protection and budget, a substantial amount of insurance will be whole life, investment-linked or term products.

While many financial advisers may suggest using only term products (and invest the difference), investment-linked policies are actually term cover with annual insurance charges and an investment component. A term policy will have a fixed premium and come with a protection limited by time (thus, term insurance), but an investment-linked insurance has an annual insurance charge that is commensurate with the age attained. Thus, a younger person will be able to enjoy a lower insurance premium than a term flat rate premium, which is based on a higher age. In addition, the invested amount will allow for the deferment of premium in the future should the need arise.

You should also consider critical illness cover, which can be built into the investment or whole life policy, or purchased separately depending on the budget. Hospitalisation insurance should also be considered unless you enjoy a group insurance scheme provided by the company you are working for. Personal accident policy, which is rather inexpensive, may also be considered.

The last exercise is to balance the desired coverage with the budget you can afford. Do not let anyone advise you to stretch your budget too far as future income is not guaranteed and it could be detrimental. All these can be worked out with the coaching of a competent financial adviser. Happy planning your life goals! ■

Have a personal finance query? Send it to: Consult the Experts, Personal Wealth, Level 3, Menara KLK, No.1, Jalan PJU 7/6, Mutiara Damansara, 47810 Petaling Jaya, Selangor; Fax: (03) 7721 8018; Email: pwmail@bizedge.com, Attn: Consult The Experts. Please include your full name, address, contact number and pseudonym, if any.