

What you can afford is not the right criterion

This week, we learn to determine how much insurance coverage we actually need. If you were to ask an inexperienced insurance agent, he would most likely ask you: 'What's your budget?' We shall take a look at it from the need-based point of view



Friends for life

● How should I start in determining my coverage amount?

More often than not, people decide on their coverage amount based on their budget, i.e. the premiums that they can afford to pay.

There's nothing seriously wrong with that approach.

It would be better, however, if you could determine the coverage amount based on how much you need rather than how much you can afford.

A doctor never ask what your budget is when he or she prescribes medication, does he?

TYPES OF EXPENSES

<i>Immediate</i>	<i>Ongoing</i>	<i>Future</i>
<ul style="list-style-type: none">● Uncovered medical expenses● Mortgage● Car loans● Credit card debts● Personal loans● Outstanding taxes● Lump sum gifting	<ul style="list-style-type: none">● Food● Housing● Clothing● Utilities● Transportation● Medical expenses● Insurance● Annual gifting	<ul style="list-style-type: none">● Children's education● Retirement



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Your needs can be generally categorised as immediate, ongoing and future.

Immediate needs are those expenses that are required upon your demise and are normally one-off/lump sum in nature.

The ongoing needs are those expenses which are recurrent in nature and are required by your family to sustain their day-to-day livelihood.

Future needs are expenses that may not be apparent but it will surely arise sometime in the future (see table).

● How do I calculate the total amount required?

You may use the total needs approach to determine your total amount required.

Under this method, you will combine your capital needs with your income needs.

Your capital needs will include those items listed in the immediate needs column while your income needs are those which appear in the ongoing needs column.

For example, the monthly income needs of family for the above-mentioned items or regular contributions to your favourite charitable organisation/ foundation, even when you are no longer around.

As to the amount to cover future needs, it's best to work it out separately and capitalise it to its present ringgit, i.e. today's equivalent value.

● Can you give an example of the total needs approach calculation?

Let's take a simple example of a person who wishes to provide his family with an annual income of RM40,000 and at the same time, contribute RM10,000 yearly to his favourite charity for a period of 20 years.

He also has an outstanding mortgage of RM200,000 and wishes to give a lump-sum gift of RM100,000 to his alma mater.

His capital needs would be RM300,000 (RM200,000 + RM100,000) while his income needs is RM1,000,000 [(RM40,000 + RM10,000) x 20 years].

Therefore, using the total needs approach,

his required coverage amount would be RM1.3 million (RM300,000 + RM1,000,000).

● So, is that my total life insurance needs?

Your total life insurance needs is actually the total amount required (as calculated above) minus your existing financial resources.

These would include your personal savings and investments, life and group insurances and your spouse's earnings, if any. So, if we were to take the example above and assume that person's existing financial resources at RM300,000, then his total life insurance needs is RM1 million (RM1.3 million - RM300,000).

● So what if I choose not to be insured at all?

In our country, there is no law to say that we must be insured. However, all of us have insurance, whether we purchase it or not.

The only question is who is insuring us — the insurance companies or ourselves. If you decide not to purchase an insurance policy, you are effectively insuring yourself or what we call, "self-insured".

When something unfortunate happens to us, our loved ones will then have to rely on our life savings to sustain themselves until other sources of income is obtained.

This may not be a very wise form of planning and certainly not as cost-effective.

When a person chooses to purchase an insurance policy, he/ she is actually transferring part of that risk to the insurance company for a fraction of the costs.

In conclusion, how much life insurance coverage one needs really depends on our own needs and circumstances.

Ideally, one should be adequately insured but circumstances are such that we may have to balance between our current needs with our future needs and obligations.

The very least you should do is to ensure that you have covered the essentials, if not all.

■ This article is prepared by the Life Insurance Association of Malaysia. Next week, we will explore the options for the best possible coverage for those with limited resources.