GOA Financial Need Analysis Helps Determine and Attain Your

It is important to understand the usefulness of Financial Need analysis and how it can help generate wealth.

IN THIS FOURTH article on Financial Planning, the focus is on the third step of Financial Planning, which is analysis and recommendation.

The emphasis is not on detailed analysis which is best done for a case study but on the principles and some practical examples. The first principle we must understand is Financial Need Analysis.

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Financial Needs Analysis

Financial needs analysis is the process of determining what your financial goals are, and then formulating appropriate plans to help you attain these goals. It is only when your needs are clearly understood that you are more likely to stay committed to the plan, and the plan has a greater chance of success.

The solutions to these needs basically involve generating the necessary wealth in the most appropriate manner for specific future needs and having resources available for contingent needs. Wealth creation is best achieved by financial instruments designed to enhance and grow your asset value over time and sufficient insurance cover for the unexpected. Hoping for lady luck to grant you the windfall to resolve your financial issues is simply wishful thinking.

Wealth Creation

To grow wealth, three elements are essential: available cash, available time, and a right plan.

First, having cash to build wealth requires discipline and sacrifice. Psyching yourself up for financial success helps you to stay the course even when the going is difficult. You will be more prepared to overcome temptations to satisfy present wants in order to build future gains. Only then will real hard cash be available to feed your wealth machine.

Second, your wealth machine will require time to generate greater wealth. The more time you give to it, the higher value it can create for you.

Third, a proper plan to grow your wealth provides you the strategies to attain your financial objectives. It should comprise not only programs to create wealth, but also safeguards to protect your wealth against life uncertainties.

To obtain insurance cover, good health is a pre-requisite. Any health impairment is likely to lead to higher premiums, partial exclusion of cover or even total exclusion of cover. Such exclusions will compromise the effectiveness of a total solution for you. Hopefully, this is a good enough reason for you to address your insurance needs as early as you can.

Analysing Needs

In analysing needs, an adviser needs not only to consider the quantitative facts that a fact-find exercise discloses, but also to uncover and appreciate qualitative facts that may not be apparent at the onset. Often these are the issues, when clearly understood and addressed will determine the successful outcome of a plan.

One area which everyone needs to plan for is retirement funding. The 'golden years' is an inevitable life stage that we all will one day enter, unless death intervenes prematurely. Basically, it represents the period when you no longer need to work for an income, yet still have the means to live comfortably till you pass on. In working your income needs in retirement, do not overlook the insurance premiums that you need to service. The funds required for retirement are not likely to be insignificant. As an example, a couple wanting a monthly income of $5,000 (in today's value) when they retire in 20 years time would need a retirement fund of $1,980,210 #1 then in order to survive the next 25 years.

The current drive to encourage senior citizens to remain actively employed, or at least to posses the skill to stay employable, has certainly blurred the line demarcating when retirement begins. This situation has arisen because a large segment of them have had no prior planning to accumulate the funds needed to survive through their retirement years. This underlines the importance to plan adequately for retirement, and it is never too early to begin preparation.

While remaining engaged in work even when you have retired is beneficial to overall health and well being, it should be your personal choice for non-monetary objectives, and not out of a necessity for livelihood.

Another financial need, if you have children, would be education funding. Overseas university education is already costly now, and will be increasingly so in the coming years. For Australia, a popular destination among Singapore students, the current fees and living costs combined is averaging S$36,000 a year. If you are thinking of having your child study there in 12 years' time, prepare to part with S$152,515 #2 then for a three-year course. And that is only for one child.

Any other funding needs can be similarly quantified, if you have the right financial knowledge and tools in hand. What follows next is formulating appropriate solutions to meet identified needs.

Providing Solutions

Solutions to the above needs can come in different forms; some may only partially address the issues, others may provide a more complete answer but at a high cost. So the challenge is to find a solution that is both comprehensive and cost effective.

Growing Wealth

A core component of the solution is to grow your wealth. To do that, we need to first determine both your appetite and your capacity for market volatility. This, in turn, will determine the range of investment instruments that are appropriate for you. Taking into consideration the time you have before the funds are needed, we can determine the required contribution you need to make in order to attain your objectives. Your contribution can be made in one lump sum or at regular intervals throughout the given time horizon. Taking the retirement example stated above, the couple would need to invest S$3,340 a month into a portfolio that yields 8 per cent yearly over the next 20 years.

The challenge here is to construct portfolios with different focuses. A core portfolio will comprise well diversified asset classes and securities designed to withstand market volatility so as to yield more stable returns over the long term. Additional portfolios built for tactical reasons will focus on higher yield opportunities in the short term. Naturally they carry greater risks, but at the same time they could give the additional boost to total returns. The overall portfolio structure should also adopt a lower risk profile as the time to liquidate for a specific need draws near.

Protecting Wealth

An equally essential component in your solution is having adequate insurance to preserve the wealth you have created. You protect your asset value by avoiding huge draw downs on your funds for expenses arising from illness or disability. You also need to ensure that money continues to be added to your investment so that your funding objectives will be achieved ultimately.

First, a life long hospitalisation cover providing comprehensive benefits is an absolute essential. If you are in your prime years, you should consider obtaining the best hospital care possible in order to maximise your chances of a quick and total recovery. As premiums are relatively low for the pre-retirement period, it is advisable to opt for the highest benefits plan available. You will have the option to downgrade your plan to reduce the burden of escalating premiums as you approach retirement age. Other beneficial features include guaranteed renewal, and portfolio underwriting (where premium changes are not based on individual claims experience, but on the entire portfolio of policyholders).

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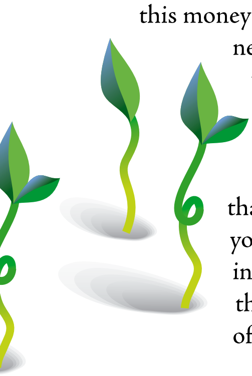
Just as important is getting insurance to provide disability benefits. Disability is broadly defined here to include critical illness, and disability arising from an illness or accident. Many are mistaken to think that hospitalisation insurance is sufficient for all medical needs. As the name suggests, it covers only expenses related to your stay in hospital; and pre- and post-hospitalisation diagnosis and consultation. But there are other expenditures or financial needs that a hospitalisation plan does not pay for. These include some long-term out-patient treatment, lifestyle and dietary changes, convalescence care that may be required for an extended period, and worst of all, the living needs of the family if you are unable to work, be it temporarily or permanently. Without an income, you will also face difficulty with contributing to your investment plan, thus jeopardizing the funding for your child's education as well as your own retirement.

To provide effective disability cover, we need to take different approaches for the different life stages because the issues involved are different.

In-Retirement Disability Cover

The objective here is to avoid unplanned depletion of your retirement fund because of health problems. It is assumed here that your retirement funding investment will complete as planned.

A permanent life plan with critical illness benefits will make a lump-sum payout in the event you are diagnosed with a dreaded disease. You can then use this money to finance your disability needs without drawing down your retirement fund.



Permanent plans ensure that that you get life-long cover so that you will never outlive your plan. They also provide increasing benefits over time, thus mitigating the impact of rising costs. In terms of premium, they are not significantly higher than term plans that cover till age 99. Furthermore, permanent plans generate cash values that will become an additional source of funds in the future. So over all, permanent plans offer better value for long-term protection.

The amount to cover is derived by estimating the additional expenditure required, as well as the period of disability. The disability period will depend on what you want to be covered for; it can range from 3 years (best case scenario) to end of life (worst case scenario). No doubt these are just guesstimates at best, and are based on assumptions. So even if you have under-provided, still it provides additional money that you would otherwise need to draw from your retirement fund.

An insurance gap does exist here though, because disability may arise from a disease not listed among your insurance contract, or it may be caused by an accident. Critical illness insurance would not pay for this. So supplement this with long term care insurance which pays a monthly benefit when you are not able to perform some activities of daily living (ADL).

Pre-Retirement Disability Cover

The focus for this period is to ensure that, from now till you retire, physical disability will not stop you from supporting yourself and your dependants, nor prevent you from continuing to invest for your investment objectives. It is important that these circumstances do not detract you from attaining your funding goals. Your child depends on it for further education, and you need a new source of income when you retire.

Term insurance is suited for this purpose because you can pre-determine when you no longer need the cover.

Here, term insurance covering death, total and permanent disability, and critical illness would be part of the answer. The term of cover is from now till you retire, and the amount to cover is the sum of your disability needs, living needs for the family, and your investment input for this period.

Again an insurance gap exists here for the same reasons covered earlier. Disability income insurance can fill this gap, but it imposes a maximum monthly benefit limit.

An alternative to level term insurance is reducing term insurance, which covers you for a sum that reduces over the period of cover. This approach corresponds with your decreasing financial need as you approach your retirement.

Death Cover

In the event of death, the above arrangements would have more than adequately provided for your surviving dependants, even for the retirement needs of your spouse.

Conclusion

Financial need analysis and recommendations seek to solve common financial issues. Hopefully this article has helped you to know what to focus on. There can be alternatives to the types of products suggested here, but it is important to understand the features and limitations of the specific products recommended by your adviser so that you can avoid any duplication, and accept overlaps that may be unavoidable. The ultimate solution for you is one that makes sense to you, and to which you can fully commit yourself.

1 Assume pre-retirement inflation at 2 per cent, in-retirement inflation at 3 per cent and investment return at 4 per cent.
2 Assume education inflation at 3 per cent and investment return at 4 per cent. Q

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