



Leverage On Your Life

By Eng Tiang Chuan

The inappropriate use of financial leverage could be devastating. However, in the case of Life and General Insurance, it provides a multiplier effect or rather give more cover without the associated huge downside amount.

In the midst of the financial tsunami we are in now, 'leverage' has become a dirty word. Many blame the current crisis on the over-leveraging done by banks and other financial institutions. De-leveraging is what many of these institutions and hedge funds are doing now. So what exactly is leverage and how can we make use of it in Financial Planning?

In secondary school science, we learn of tools or machines that help us in work, mostly involving movement of weights. In the course of using such tools, we can move much heavier loads using a smaller force, or in other words, getting a higher output with a smaller input. In do so, we exercise leverage.

The meaning of the word 'leverage' in the financial world often means the use of different financial instruments or borrowed money. Leverage can be achieved through instruments like margins, options and futures. A small outlay of capital can bring about a much higher potential investment return. However, just like how a user can be hurt badly through the mishandling of a tool, the misuse of leverage financial instruments can also be financially disastrous.

So, is there any form of financial leverage that offers the advantages without the associated risks?

Before answering the question, let's look at three case studies on how leverage can be applied.

CASE STUDIES

Desmond is a single 25 year old who has just found a job after graduating from university. Being a fresh graduate, he has limited savings and his source of financial returns will most likely be from his salary.

Elaine is a married mother of two in her early 40s and works as a manager

in an engineering firm. With the help of contributions from her husband, she has managed to save up a substantial amount of savings and investments.

Mr Lim is a successful businessman in his mid 50s. Due to his lucrative business, he has managed to amass more than enough wealth to last him his lifetime.

All of them have their own concerns. For Desmond, due to the stage of life he is in, there is little or no savings or investments he or his family can access to in times of need. In Elaine's case, her accumulated assets would be just enough to help her family cope financially in the short to mid term if any unfortunate events happen. On the other hand, Mr. Lim's concern would be to safe guard his assets from any potential business liabilities and to leave a legacy for his loved ones or some organization of his choice.

For all of the above cases, their financial status could be adversely affected if some unfortunate event were to strike, particularly during a financial crisis or economic slowdown like now. Their jobs, investments or value of their assets could be severely affected. Many markets in the world have seen the index falling 50 per cent or more this year. This would severely limit the positive impact of liquidating investments and assets to cushion the financial hardship that could follow. Furthermore, liquidating assets in such times could hinder long term retirement or educational plans and ignite a vicious financial cycle that could span generations.

For Mr Lim, he faces the additional responsibility of business related liabilities and risks that could, not only affect him, but also his family.

THE SIMPLE ANSWER IS...

The simplest way to hedge themselves against dreaded situations and to achieve


leverage is through insurance. With a small premium outlay, the life assured will be granted a substantially greater coverage. The payouts can ensure a continuation of similar living standards and progression of plans. There would be little need to liquidate investments and assets and thus avoid the risks of facing a depressed market.

For instance, in Desmond's case, a yearly premium of just \$411.80 for a Disability Income plan for a 25 year old male non-smoker would leverage him to a potential payout of \$1.7 million over the next 39 years! Proper planning would help ensure the prevention of the start of a vicious financial cycle.


CONCLUSION

Just like how an engineer can leverage on machines and technology to build homes for a secured future, we can leverage on insurance to build a secured financial future. As we have seen with the current financial crisis, inappropriate use of financial leverage could result in calamity. Life and General Insurance provide a multiplier effect without the associated huge downside. It would certainly make sense to use a small part of your wealth to cover and leverage to a much higher amount. Leverage on your life today! ■■

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The table below summaries the possible concerns and solutions:

| Party | Current Situation | Concerns | Solutions |
|---------|---|--|---|
| Desmond | Fresh Graduate with little savings and assets. | <ul style="list-style-type: none"> Loss of potential future income Long-term medical and treatment cost Loss of ability to provide for dependents, namely parents | <ul style="list-style-type: none"> Leverage through Life and Health Insurance |
| Elaine | <ul style="list-style-type: none"> Career woman in early 40s married with 2 children Some form of savings and investments | <ul style="list-style-type: none"> Loss of potential future income Long-term medical and treatment cost Loss of ability to provide for dependents, namely parents and children | <ul style="list-style-type: none"> Leverage through Life and Health Insurance |
| Mr Lim | <ul style="list-style-type: none"> Successful businessman in mid 50s Have amassed substantial assets | <ul style="list-style-type: none"> Protection of assets from creditors Business liabilities arising out of negligence Continuation of business in event of incapacity Distribution of wealth to dependents or organization of choice | <ul style="list-style-type: none"> Protection of assets using Trust. Options include Statutory Trust (setup using Insurance) or Offshore Trust (Setup using Portfolio Bond) Protection and leverage through General Insurance like Professional Indemnity and Error and Omission Keyman Insurance Through Estate Planning, Wills and Trusts |

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