Insurance Financial Planning, & Cytonn Weekly #07/2022

Focus of the Week

Financial Planning refers to a systematic approach towards managing one's finances by allocating resources optimally in an effort to maximize the use of these resources in order to achieve one's financial goals and objectives. Having a comprehensive financial plan is important as it enables one to achieve financial freedom by actively managing their spending habits, work towards wealth generation while taking cognisance of their current and expected income levels. Recent economic challenges such as the COVID-19 pandemic have made it difficult for many Kenyans to stick to their financial plans as many were not prepared for the adverse effects of the pandemic such as income disruption and job layoffs. Such unexpected financial occurrences highlight the importance of a financial plan that is inclusive of ways of how to deal with unexpected financial occurrences including emergency savings and taking up insurance covers.

Insurance covers help give one a financial protective cover against different types of financial risks. Despite the importance of insurance, Kenya's insurance penetration rate remains at a paltry 2.2%, as per the IRA Annual Report 2020 behind countries like South Africa which had an insurance penetration rate of 13.7%, and the global average of 7.4%, as of 2020. Insurance penetration rate refers to the ratio of gross insurance premiums to a country's Gross Domestic Product (GDP) and indicates the level of development of the insurance sector in the country. It is in light of these statistics and bearing in mind the importance of insurance planning, that we chose to discuss the topic in order to continue sensitizing the market on the importance of personal financial planning, and in particular insurance planning.

Previously, we have published the following topicals on financial planning:

?. Personal Financial Planning in August 2019 and February 2020 - We discussed the importance of financial planning, the various considerations to make based on one's own characteristics, needs and preferences and some of the investment avenues available,
i. Financial Planning Amidst COVID-19 in June 2020 - We covered the effects of Coronavirus on financial planning and financial planning opportunities in the coronavirus environment,
ii. Financial Planning for Retirement in August 2020 – We focused on how to plan your finances in preparation for retirement given its inevitability, various types of pension schemes and where pension schemes invest, and,
iii. Financial Planning for Education in March 2021 - We analyzed various education plans, looked at why one should invest, best financial planning tips to consider and the factors at play when selecting a suitable education plan.

This week, we will cover the following sections:

?. Introduction to Financial Planning,
i. What is Insurance Financial Planning?
ii. Tips on choosing the Right Insurance Policy, and,

iii. Conclusion.

Section I: Introduction to Financial Planning

Personal financial planning refers to a systematic approach towards managing one’s finances in an effort to maximize the finances in a manner that will aid in the achievement one’s financial goals and objectives. Financial planning involves a process that consists of the following steps:

i. **Assessment: In this step, an individual assesses their current financial situation by identifying various factors that could possibly affect their financial plan. At this point, it is important to ask questions such as; what is my current income? What are my financial objectives? What are my spending habits? Etc. The aim of this step is to evaluate the individuals personal income, spending habits, lifestyle and see how each of them affects their financial plan,**
ii. Goal Setting: In this step, the individual outlines the financial goals they want to achieve in the long-run, as well as the next actionable steps to achieving these goals. Ultimately, this provides a clear roadmap towards the achievement of one’s financial objectives,
iii. Execution of the financial plan: This refers to how best one can action the laid out plans. A well laid out plan should highlight the suitable channels and instruments that will be used to achieve the goals. An inclusion of timelines is also important, but this depends on if it is a short term investment e.g. Money Market Funds or long term investments e.g. Bonds and Real Estate, and,
iv. **Monitoring and reassessing the financial plan:** Given that goals and priorities change over time, it is important to monitor and reassess the financial plan created, leaving room for readjustments along the way if necessary. Constant reviewing allows you to analyse your individual investments and determine if they are worth keeping, as well making sure they align with any changes that might have occurred along the way.

To achieve one’s financial goals there are some key habits that one needs to practice;

i. **Saving**: Saving entails consuming less out of a given amount of resources in the present in order to consume more in the future by setting aside part of your income in some form of asset. Efficient saving requires discipline, where we should always treat savings as a necessary expense,
ii. **Investing**: Investing involves the purchase of an asset with the hope of generating income or capital appreciation. Saving is often confused with investing, but they are not the same. Saving focuses on capital preservation whereas investing focuses on wealth generation in addition to capital preservation, for the majority of investment products. There are different asset classes that one can invest in and an investor will choose their preferred investment vehicles based on their risk tolerance and appetite, the returns expected and the liquidity requirement. It is important to diversify one’s portfolio through investing in different instruments in a bid to mitigate risk,
iii. **Debt and Debt Management**: Is debt good or not? Debt is only good if used towards an investment or for future financial gain such as business, education, or property. However, it is advisable to take up debt for investment only if the economic rate of return, which is simply how an investment’s economic benefits compare to its costs, is able to finance the debt repayment. Anticipating future needs and saving adequately for them can help in minimizing the need to take on debt, and,
iv. **Budgeting:** Budgeting is simply creating a plan on how to spend your money. Budgets help guide and control your expenditure. It is important that you have the discipline to create a budget around the resources you have and stick to it. When budgeting, prioritize your needs and necessary expenses and try as much as possible to cut down on unnecessary expenses to save money. Additionally, it is vital to review your budget regularly as the circumstances around you and responsibilities change.

Section II: What is Insurance Financial Planning?

In this section we will focus on different ways in which one can deal with financial emergencies before delving in insurance financial planning:

A. Planning for Financial Emergencies

A financial emergency is an unexpected occurrence that has a risk of destabilizing one's financial position. It includes some of the following examples: i) Loss of employment, ii) Medical emergencies such as injuries arising from a car accident, iii) Death of an earning family member or spouse, iv) Unexpected car expenses, v) Forced relocation due to job change, and, v) Natural disasters such as earthquakes and mudslides. The main ways of dealing with financial emergencies include:

a. **Building up an Emergency Fund** - An emergency fund is a form of self-insurance whereby an individual puts aside some money in order to reduce and possibly eliminate financial distress arising from unexpected situations. It is key to note that an emergency fund in this context is different from savings plans for other purposes such as housing, education, and retirement. It is recommended to first build your reserve, the emergency fund, up to the intended goal amount before then proceeding to save for other financial goals. The recommended amount to put aside is 3 to 6 months equivalent of your living expenses. For instance, if one earns Kshs 50,000 per month, the recommended emergency fund size should be Kshs 150,000 to Kshs 300,000,
b. **Exploring other sources of income** – An extra source of income will ensure one is able to build your emergency fund and increase your overall savings level. Higher savings levels will help to minimize the impact of unexpected financial losses as there will be sufficient cash in reserve to cover them, and,
c. **Taking up Insurance Covers -** It is advisable to take up insurance covers as not all unforeseen financial obligations can be offset by the emergency fund. Insurance enables you to work and live without fear as you know that should anything happen; the insurance cover will cater for the expenses. It is key to note that the a maximum claims settlement is not guaranteed, due to factors such as depreciation of property, replacement costs and exclusions in the policy, and insurance companies will need to be absolutely satisfied as per the terms and conditions applicable before settling a claim fully. Insurance policies are sometimes misunderstood and you should seek the advice of an insurance agent before choosing the policy that suits you in order to understand key concepts such as the cover period, the various terms and conditions and the premium payable for a particular insurance policy.

B. Importance of Insurance Planning

Insurance is an important part of financial planning because it protects an individual and their loved ones from costs and losses associated with accidents, disability, natural disasters, illnesses and death. Some of the main benefits of insurance include:

a. **Financial Security –** A key benefit of insurance is the replacement of lost or damaged assets. Insurance covers can, for example, help to minimize business disruptions or even income disruption,
b. **Medium of saving and wealth generation –** Some insurance covers help you save towards different financial goals in a regulated and low-risk environment. These types of insurance covers include Unit Linked long term insurance policies whereby part of the premium is used to purchase life protection and the rest is used to purchase units in an investment fund managed by the insurance company. Additionally, education savings plans help guardians to secure their children's education by providing a flexible platform with the additional benefits of waiver of premiums in the event of death of the guardian,
c. **Peace of mind –** Insurance helps improve the quality of one's life as it assures them that if anything adverse were to happen to their loved ones or assets, they will have gain financial respite, and,
d. **Protection of your loved ones –** While money cannot replace the presence of a family member,

taking covers such as life insurance can help in ensuring that even after one is gone, the family and dependents have some funds to endure any financial hardship.

C. Types of Insurance Covers in Kenya

An insurance policy is a document evidencing the existence of an insurance contract containing the terms and conditions of the contract. There are two main forms of insurance namely life / long term and general / short term insurance. The key difference is that life insurance contracts are usually more than one year while general insurance contracts are for one year or less.

Main Types of Insurance Covers in Kenya

General / Short Term Business	**Life / Long Term Business**
Motor Insurance	**Life Assurance Policies**
Liability Insurance	**Education Savings Plans**
Fire and Burglary Insurance	**Pension Plans**
Marine Insurance	
Workers Compensation (as under the Work Injury Benefits Act –WIBA)	
Medical Insurance	

Understanding the various types of insurance policies is key as each policy type has different sub-classes and rating factors. For instance, property insurance is divided into domestic insurance, fire and allied perils, burglary insurance, plate glass and all risk insurance. All these types of insurances have different rating factors and hence, our view is that it is vital that an individual or firm seeks professional advice before purchasing insurance policies to ensure that their specific needs are met.

Section III: Choosing the Right Insurance Policy

Choosing the right insurance policy involves analysing both internal factors and external factors. Under the self-assessment step, individuals analyse the various internal factors including their income, spending habits, age, gender, number of dependents and state of one’s health. Other factors that one needs to consider are external such as the financial health of the insurance company, customer service and how the insurance cover works, as explained in detail below:

1. **Reputation / Financial Health of Your Insurer** – The financial health of an insurance company is important as ideally a client would want an insurance company that is well run and will be around when a claim occurs. Additionally, reputation is an important consideration especially in claims payments as clients prefer insurers who have a reputation of fast and efficient claims processing – however, at times an insurance company could earn a bad claims processing reputation unfairly and clients are advised to consult expert advice from qualified intermediaries to ensure they make the right decisions,
2. **How your Insurance Works** – Generally speaking, it is important to understand how your particular insurance cover of interest works, that is the policy document contents, exclusions, contact persons. Here the individual may consider their preferred length of insurance plan and flexibility, and, if the insurance policy they are assessing can cater to their individual needs,
3. **Affordability of Premiums** – It is important for one to choose an insurance plan that one can afford to pay the premiums, especially for long term insurance/life insurance. For short term general insurance, affordability is also key and first time buyers may shop around to find out the cheapest option in the market that also caters to their needs.

Other factors are more specific to the type of cover that a client wants, for example for medical insurance, one may consider the following factors:

a. **Additional Benefits** - There are obvious services that the healthcare plan will clearly tell you about and outline in 'black and white'. However, there may be other additional benefits that may not be as apparent. An interested client should ask about these peripheral benefits, and find out what is covered, and if there any other additional fees,
b. **Medical Provider Network** – It is important to ensure that one's preferred healthcare plan is accepted by their current healthcare provider, hospital and pharmacy. Policy holders prefer medical covers that have a wide provider network to ensure that regardless if where they may be, they can still enjoy the cover, and,
c. **Medicine Coverage** - Medical prescriptions are the largest expense for most people's healthcare plans. Therefore, make sure to consider whether it is included in your plan, and how much is covered.

Below is a table showing the different stages of one's life and common policies taken in each:

Stage in Life/Employment Status	Common Types of Insurance for the Stage	
Young Adult (Single)	• Personal Accident Cover • Health Insurance • Burglary cover	
Married	• Life insurance • Mortgage Insurance • Domestic/Home insurance	• Investments/Endowment plans • Pension
Married with Children	• Life insurance • Education Plans • Domestic/Home insurance	• Investments/Endowment plans • Pension
Business Owner	• WIBA • Professional indemnity • Business interruption	• Goods-in-transit • Money insurance • Theft insurance • Fire and perils.
Employed	• Health Insurance (May be provided by employer) • Life insurance (May be provided by employer) • Pension	
Retired	• Medical Insurance • Annuities/ Draw down	

Section IV: Conclusion

In conclusion, financial planning is a practice that can be tailor made for any need and with insurance plans being a vital need, we believe that more Kenyans should include insurance plans as part of their comprehensive financial plan. Below are a few tips that are useful when looking for an insurance cover in Kenya:

1. **Shop around -** There are many insurance companies and a wide variety of coverages out there. If you're looking for clarification, you may want to consider working with an agent (who sells insurance for just one company) or through an insurance broker (who represents multiple insurance companies) instead of buying online directly,
2. **Ask your insurance provider what the policy does not cover -** Every insurance policy lists perils that are not covered, known as "exclusions". It is important to ask the insurance provider to explain the exclusions in your policy at the outset, which will save you the stress and frustration of discovering them after you incur damage or a loss,
3. **Consider bundling several policies with one insurance company -** If you are looking to insure multiple vehicles or obtain multiple types of business coverage (like liability, property, and

cyber risk), then you may want to find a single insurance provider who carries multiple products and enjoy possible discounts (usually through negotiations),

4. **Review your insurance needs on a yearly basis -** As your needs evolve, so will your insurance policy. When you've made a change, it's important to consider whether your policy needs to adapt to new risk exposures
5. **Do not defer payments -** Default of payment is considered a "bad risk", which can lead to a higher rate. If you decide you do not want to renew your policy, you should immediately notify the insurer in writing, and,
6. **Take measures to minimize risk and prevent loss -** Risk management can go a long way in helping you stay protected e.g. if it is a home insurance, install CCTVs, hire a security guard etc. This also help in minimizing premiums. Good planning and the right protection can help you stay ahead of risk in your day-to-day operations.

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