Preparing for Financial Emergencies

There's no way to predict a financial emergency—but you can be prepared for one. While no one expects to be affected by fire, flood, sudden illness, unemployment or any of the other hardships that life may bring, it's important to be prepared for the unexpected. By building up your financial reserve and using a variety of financial tools and tactics to protect your assets, you can help lessen the impact of a financial setback.

Building an emergency fund

It's easy to put off creating an emergency fund, especially if money is tight. However, if you have little to no emergency funds and a disaster strikes, you may be forced to take a loan, rack up credit card debt or withdraw retirement funds to make ends meet. Most financial experts recommend saving enough to cover six months' worth of expenses. If this seems overwhelming, start with setting a weekly savings goal. Even saving $50 per week can help build up your fund, and by automating these savings or putting extra money gained from a part-time job, tax refund, raise or an unexpected inheritance, you can make saving relatively effortless.

It can also help to keep this money in a separate, secure account; having a physical separation between your emergency fund and your regular bank account may help you keep a psychological separation in how you think of the two accounts, as well. Think of putting the money into this account as paying a bill rather than as an optional expense, so you're forced to "pay yourself" each month. Remember that an emergency fund should be used for just that—emergencies—so you shouldn't need to dip into it to pay for planned expenses, such as car payments or rent. Maintaining the self-control to deny yourself access to this account can be difficult, but it will pay off when you truly need it most.

Protecting your assets

Beyond building up additional funds, insurance can also help hedge against a variety of financial hardships. Consider the following types of coverage to safeguard against potential loss due to unexpected circumstances:

> The longer you put off creating an emergency fund, the more you put yourself at risk if financial disaster strikes.

Health insurance. Whether you receive coverage through your employer or the Health Insurance Marketplace, having health insurance is not only advisable—it's now mandatory. Forgoing health insurance can make a sudden hospitalization or illness financially catastrophic, and it will force you to pay a penalty fee to the government.

Auto insurance. Most states require drivers to have at least liability coverage, which covers bodily injury and property

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damage. However, there are also additional types of insurance, such as collision and gap insurance. To determine the best coverage for you, you'll have to assess your needs based on the value of your car as well as state legislature. Keep in mind that accidents can be extremely costly, so even if you aren't required to have auto insurance, it can help you significantly in case of an accident.

Long-term care insurance. Health insurance and Medicare cover only a limited amount of long-term care, such as a nursing home stay or even the cost of having an in-home nurse. This care is costly to pay out-of-pocket; nursing home costs can range from $220–$250 per day. Long-term care insurance can cover you for several years and generally comes with a daily and lifetime maximum benefit limit. Keep in mind that the cost of long-term care increases the longer you wait to buy it. If you do want to consider long-term care insurance, you should do it sooner rather than later. This can protect you from draining your retirement savings to pay for medical care.

Life insurance. Having life insurance is especially important to protect your spouse and family should one of you die before reaching retirement age. Life insurance can help to replenish the income that your family would lose in case of your death. The more people that depend on your income, the more important it is to have life insurance.

Homeowners/renters insurance. Both of these types of coverage can help protect your assets in case of damage or theft. Renters insurance is particularly inexpensive for the peace of mind it offers. Also, depending on your homeowners policy, you may need to purchase additional insurance to protect against flooding or other natural disasters that could otherwise devastate your assets.

Disability insurance. Disability insurance helps to replace your income if you become disabled and are unable to work. You can obtain disability insurance through your employer or a private insurance company, or you can apply for Social Security disability benefits.

Umbrella insurance. This type of insurance will help cover additional liability beyond your standard policies, serving as a catchall for emergencies that exhaust your other insurance.

Diversifying and selling investments

Keeping your investments diversified, both by industry and asset class, can be thought of as a hedge against economic swings. Diversification means that if one sector of the economy or asset class is doing particularly poorly and your shares of those securities drop, it will only directly affect one part of your portfolio rather than devastating your portfolio as a whole. While there is no way to guarantee 100 percent protection for your money when investing, diversification is a good option to give you some peace of mind.

If you find yourself needing to liquidate some of your assets to pay off a financial emergency, it's generally advisable to sell off your taxable investments first, rather than dipping into your 401(k) or IRA. Selling investments from your retirement account could trigger tax penalties for early withdrawals, and the money within these accounts grows faster than money in taxable accounts, so withdrawing from these funds will likely cause greater damage to your potential for asset growth.

Managing the cost of borrowing

If you must borrow money to cover the cost of a financial emergency, you should carefully compare all cost options available to you before choosing one. Interest rates as well as lender attitude will vary from loan to loan, so remember that you don't need to take the first loan offered to you, even if you're desperate for funds. You should also consider that keeping your debt low or at least manageable prior to a financial emergency could make a big difference in how you're able to handle it, since low or no debt will mean you won't be making loan payments while trying to handle the additional cost of a financial emergency.

Organizing and securing your financial records

Keeping your financial records organized can make it easier to react to a financial emergency; it can help you find receipts for insurance claims, provide you with copies of your debit or credit cards if they are stolen and help you have an inventory of your personal property in case of a fire or flood. Keeping your important documents, such as bank account information, deeds, titles, wills, living wills, powers of attorney, insurance policies and birth and marriage certificates can also help prevent certain types of financial emergency, such as identity theft. Beyond building up and protecting your financial assets, you'll want to ensure that you are familiar with all parts of your financial plan and that you know how to access them, should you need to. ■