

Life Insurance Basics

With the ever-changing landscape of taxes, it is growing increasingly difficult to understand how legislation affects clients and could possibly impact their financial future. As a leader in the financial services industry for the past 30 years, we get it. That's why HD Vest Financial Services® is constantly seeking ways to share the latest knowledge we acquire with you. We've created the Taxes & Investments: Timely and Timeless Strategies Series to share timely information and provide our Advisors and their clients with practical information and ideas they can build on.

Life insurance is one of the most important financial purchases an individual can make. In the event of a tragedy, life insurance proceeds can help pay bills, continue a family business, finance a child's education, protect a spouse's retirement plans, and much more. If a wage earner passes away, a family could be devastated financially without life insurance.

What is life insurance?

A life insurance policy is a contract with an insurance company. In exchange for premiums (payments), the insurance company provides a lump-sum payment, known as a death benefit, to beneficiaries in the event of the insured's death. This benefit is typically tax free to the beneficiaries and bypasses probate.¹

Types of Life Insurance

There are many different types of life insurance policies and the type of policy chosen is based on the needs and goals of the owner. Life insurance is broken down into four main types: term insurance, universal life insurance, variable universal life insurance and whole life insurance.

1. **Term Life Insurance-** Term life insurance is the simplest of the life insurance options. It is designed to cover an individual for a pre-defined period of time and it typically only pays out a death benefit to the beneficiary if the owner dies during the term period. Term insurance premium payment amounts may be level or increasing over the term depending on the policy, and the premiums are typically lower than other insurance options. This type of policy is typically best suited for those with temporary insurance needs such as paying off a mortgage or protecting a child's education needs.
2. **Guaranteed Universal Life Insurance-** Guaranteed universal life insurance is a permanent insurance policy that protects the owner for their entire life assuming death benefit guarantee premium payments are made. It has components of both term and permanent life insurance. This type of policy has a death benefit as well as a cash account that is held in the insurer's general account. As long as the premiums are paid as illustrated and no loans are taken on the policy, the death benefit is guaranteed to remain in force for the period illustrated (typically to age 100, 110 or 120). This type of policy is best suited for individuals who need a permanent life insurance policy but are not concerned with cash value accumulation.

3. **Variable Universal Life Insurance**- Variable universal life insurance is a permanent insurance policy that builds up cash value. The owner has the flexibility to increase or decrease premium payments. The death benefit will be paid if the insured dies any time as long as there is sufficient cash value to pay the costs of insurance. The policy allows the owner to invest the cash value in variable subaccounts. The policy value will increase or decrease based on the performance of the subaccounts selected. It is possible for required premiums to increase to keep the policy in force if the underlying investments cause the cash value of the policy to drop below the cost of insurance. This type of policy is best suited for individuals who need permanent insurance coverage but would like to grow and access the cash value of the account through potentially tax-free loans and/or distributions.¹

4. **Whole Life Insurance**- Whole life insurance is a permanent insurance policy that builds cash value based upon a set schedule. The exact cash value of the policy is known for each policy anniversary. If a loan or withdrawal is taken from the policy the cash value and death benefit will decrease. Whole life insurance policies may also pay dividends which helps to increase the cash value of the policy. This type of policy is best suited for individuals who need permanent insurance coverage and who may want to accumulate tax-deferred savings.

Insurance Types Comparison				
	Term Life	Guaranteed Universal Life	Variable Universal Life	Whole Life
Protection Period	Fixed period set at issue	Generally for the life of the owner	Generally for the life of the owner	Generally for the life of the owner
Typical Cost	\$	\$\$	\$\$	\$\$\$
Premiums	Fixed	Fixed	Variable	Fixed
Investment Options	No	No	Yes	No
Cash Value	No	Yes	Yes	Yes
Cash Value Growth By	N/A	Guaranteed Interest Rate	Subaccount Investments	Guaranteed Interest Rate and Dividends
Loans Available	No	Yes	Yes	Yes

How Cost is Determined

Insurers use rate classes, or risk-related categories, to determine premiums. A few of the elements of the traditional rate classes are:

- **Standard:** Good health, average cholesterol, relatively low-risk lifestyle
- **Preferred:** Very good health and family medical history, low cholesterol, low-risk lifestyle
- **Super-Preferred:** Excellent health and family medical history, very low cholesterol, low-risk lifestyle

The rate class is determined by a number of factors including overall health, family medical history and lifestyle. Tobacco use, for example, would increase risk and therefore cause the premium to be higher than that of someone who doesn't use tobacco.

Coverage Amount

The amount of insurance each individual needs varies depending on their unique situation. Below is a very basic calculation to help determine the amount of insurance need, but an HD Vest Advisor can help calculate a more customized insurance need amount.

Burial Costs:	\$ _____	(Typically \$15,000-\$20,000)
+		
Debts:	\$ _____	
+		
Child's Education Needs:	\$ _____	
+		
Family Income Needs:	\$ _____	
+		
Special Bequests:	\$ _____	(I.e., gift to a university, church, etc.)
= Total Insurance Need:	\$ _____	

Life insurance is the foundation of an individual's overall financial plan. No matter how much financial planning someone has completed, it could all be for naught with the death of a family member. HD Vest Advisors are exceptionally qualified to help determine the most suitable amount of insurance and type of policy to protect against the financial hardships loved ones left behind could face.

Sources: 1. IRS Publication 525- Life Insurance Proceeds

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