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WealthWise

Investment Perspectives from HSBC

A Critical Component Your Financial Strategy May Be Missing

You may be missing out on a flexible tool for saving and wealth transfer by strictly limiting its role. Learn why you may want to broaden your view.

Quick: "Life insurance." What do you think of when you read those words? Most likely, you call to mind very specific, immediate needs associated with the loss of a loved one, such as covering funeral expenses. Or you may think of the most common use for its end-of-life payout: Fully 53% of people buy life insurance primarily to replace income that would be lost with the passing of a provider for the household, according to insurance industry research firm LIMRA.[1]

"Income protection is the main reason people seek life insurance," points out Mario Lazzaro, Vice President of Insurance at HSBC. "Most people simply don't have the assets set aside that they would need to replace a wage earner's contributions. An insurance policy can help offset that financial risk."

But there's more to a life insurance policy than providing immediate financial security for your family when you pass away. Some types of life insurance, used strategically, can play a significant role in supporting your overall financial life. A well-chosen policy's death benefit can also serve as a primary component of a business succession plan, or assist you in transferring more of your estate's value to your heirs. In the meantime, a policy can help you set aside more money for retirement or offer a flexible way to save for a child's college education.

"The right policy not only can protect your family but can also help you build wealth and prepare for retirement," Lazzaro says.

A Tool for Saving

He suggests that consumers choosing a life insurance policy first consider a particular selection in the context of their primary goals, such as income replacement. If the policy fits those primary goals, Lazzaro further recommends looking into whether it can do double duty to potentially serve other goals. For example, universal or whole-life insurance policies offer death benefits but can also can function as a savings tool for policyholders.

One way to take advantage of life insurance is to boost retirement savings.

HSBC Securities (USA) Inc.
452 Fifth Avenue
New York, NY 10018
1-800-662-3343

Talking Points

Consider raising these questions with your Financial Advisor as you review your total financial picture:

- Do I currently have life insurance coverage adequate to replace my income?
- In what other ways might I use life insurance to work toward my financial goals and personal needs?
- How could life insurance support my retirement strategy?

Someone who is already making the maximum contributions to traditional tax-advantaged retirement vehicles such as 401(k)s and IRAs might consider investing in a universal or whole-life insurance policy. And accessing life insurance savings can be as simple as withdrawing a portion of the policy's cash value.[2] "These can be powerful savings tools because the policy's cash value isn't taxed as it accumulates," Lazzaro says.

> Universal or whole-life insurance policies can be powerful savings tools because the cash value isn't taxed as it accumulates.
>
> *—Mario Lazzaro, Vice President, Insurance, HSBC*

Another option is to use a life insurance policy to help save for a child's college education. Premium payments will take advantage of these policies' tax advantages and benefit from their considerable flexibility. Unlike some college savings vehicles, life insurance policies don't penalize you for using the funds to pay for noneducational expenses. For instance, if your child decides not to go to college, you can choose to keep those funds as part of your life insurance policy or simply withdraw them for other uses.[3]

The Next Generation

A universal or whole-life insurance policy can play a critical role in helping to pass more of your hard-earned assets to your heirs. From an estate planning perspective, you can earmark a life insurance policy to cover potential taxes on any financial bequests, which can make it possible for you to leave larger values to your loved ones while also making the disbursement process easier.

If you own a business—whether a family farm or a manufacturing firm—life insurance can make it easier to pass an ownership stake to your successors. For example, a light manufacturing firm typically has significant assets tied up in operations, from property and equipment to stock and receivables. Handing that firm down to heirs would likely trigger a sizable tax bill, and finding the liquid cash to cover that bill might be difficult for heirs. As a result, a firm owner may choose a life insurance policy that will provide the family with liquidity in case of a triggering event.

Business partners may also take out life insurance policies on each other: If Partner A dies, a policy owned by Partner B—with Partner A as the insured—can generate a death benefit that Partner B may use to purchase Partner A's stake in the business. "Life insurance can equitably transfer that partnership to the remaining owner and compensate the other partner's family for their involvement in the business," Lazzaro says.

Just like your overall financial strategy, the right policy will take into account your own needs and goals. Fortunately, the many different types of life insurance policies—and different ways of structuring each policy—mean you are likely to find an appropriate option. Your Financial Advisor and independent tax professional can help you navigate the options to make sure you choose the right plan for your personal situation.

[1] LIMRA, "U.S. Buyers and Non-Buyers of Life Insurance, 2011."

[2] Policy withdrawals may be taxable, depending on how they are withdrawn and depending on the type of policy. Withdrawals to policy basis (total premiums paid) are not taxable, and policy loans are not taxable as long as the policy is not a modified endowment contract (MEC). If the policy is an MEC, any gain is withdrawn first, and such a withdrawal is taxable.

[3] Withdrawn policy gains may be subject to income tax. Loans against cash value can generally be taken tax-free. Check with your qualified tax professional about potential ramifications before making a decision.

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