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Income Term Insurance: It Pays Out Over Time

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A few insurance companies are developing term life insurance products that will make periodic death benefit payments to the beneficiary upon death of the insured. At least two carriers already offer it.

The policies can be set up to pay a lump sum at the time of death, too, as with traditional term life insurance. Also like traditional term, this coverage pays benefits only if the insured dies within the term period.

But the purpose of this new type of term coverage is to enable the beneficiary to replace lost income over a period of several years. Beneficiaries can use the periodic payments to cover ongoing expenses or for any other purpose. Because these payments function as income, some industry observers are terming this coverage “income term.”

Here is an example. Take a 35-year-old married couple with two children. Typically, the couple would purchase a traditional level term life policy to provide enough funds to offset financial obligations upon death of the primary income-provider.

■ TABLE 1

Traditional Level Term Assessment Lump Sum Financial Needs

		In 5 years	In 15 years	In 25 years
Changes over time	o/s Principal on primary residence	\$375,000	\$300,000	\$135,000
	o/s Principal on vacation home	\$200,000	\$150,000	\$75,000
Remains fairly stable	General outstanding debt (Credit Card balance, Car payment balance, etc.)	\$15,000	\$15,000	\$15,000
	Cash required to provide for unexpected needs	\$25,000	\$25,000	\$25,000
Total		\$615,000	\$490,000	\$250,000

Note: This assessment is for a married couple, both age 35, with two children

Source: Chuck Preti, Life and Annuity Brokerage Solutions, LLC, Niagara Falls, NY

The problem is that the actual financial need changes over time, depending on the insured's own situation, age, and other factors. (See Table 1.)

Assume this couple's goal is to relieve themselves of the financial obligations shown in Table 1 should the primary income-provider die within the next 30 years. If the couple is considering a 30-year level term policy, what should the face amount be?

A \$615,000 face amount would cost them more than they need, because they clearly will not need \$615,000 over the entire 30-year period. Conversely, a \$250,000 face amount would leave them shy of what is required, except if death occurs during the final 5 years of the 30-year term. Choosing something in the middle means there will not be enough funds if death occurs early in the term period.

An income term approach handles things differently. It realizes there will always be a need for some amount of lump sum death benefit. However, it also recognizes that the family needs an income stream that is payable until the end of the term period. An income term product meets this need by enabling beneficiaries to translate what was previously a changing lump sum financial need to a known quantity. (See Table 2.)

■ TABLE 2

**Income Term Assessment
Income And Lump Sum Financial Needs**

		In 5 years	In 15 years	In 25 years
Income need remains fairly stable	o/s Principal on primary residence	\$2,700/month for the next 30 years		
	o/s Principal on vacation home	\$1,300/month for the next 30 years		
Lump sum remains fairly stable	General outstanding debt (Credit Card balance, Car payment balance, etc.)	\$15,000	\$15,000	\$15,000
	Cash required to provide for unexpected needs	\$25,000	\$25,000	\$25,000
Total		\$40,000 + \$4,000 per month		

Note: This assessment is for a married couple, both age 35, with two children
Source: Chuck Preti, Life and Annuity Brokerage Solutions, LLC, Niagara Falls, NY

Instead of debating the appropriate face amount for the 30-year level term policy, the agent can offer an income term policy that provides a \$40,000 lump sum plus \$4,000 per month until the end of the term period. This fits nicely with the couple's changing need.

A death benefit payment of \$4,000 per month could potentially total \$1,440,000 (\$4,000 x 360 months). Therefore, when adding the \$40,000 lump sum payment, the maximum total death benefit from Table 2 is \$1,480,000.

But it would be unfair to compare the premium of this income term policy with a \$1,480,000 30-year level term policy. This is so for two very important reasons:

- 1) There is a very good chance that if a benefit is paid on the income term policy, it is likely that this payout would not commence within the first month of the term. If the insured were to die half way through the term period, then the total benefit becomes just \$760,000.
- 2) A total benefit payment of \$1,480,000 paid over 30 years is clearly not worth as much to an individual as a \$1,480,000 lump sum payable immediately.

Based upon current pricing in the marketplace, Table 3 provides useful information for comparing traditional level term costs to those of income term policies.

TABLE 3

**Benefit Comparison
Traditional Level Term To Income Term**

	Annual premium for a \$1,000,000 face amount term policy to age 65 ^A	Estimated monthly death benefit for the income term policy ^B	Maximum total death benefit for the income term policy	Minimum total death benefit for the income term policy ^C
35-year-old male, preferred	\$975	\$7,528	\$2,710,080	\$451,680
45-year-old male, preferred	\$1,400	\$10,163	\$2,439,120	\$609,780
55-year-old male, preferred	\$2,000	\$15,375	\$1,845,000	\$922,500

A Based upon a sampling of competitive term products.
B Actuarially equivalent amount.
C Assuming death payments begin, then they are paid for at least 5 years.

Source: Chuck Preti, Life and Annuity Brokerage Solutions, LLC, Niagara Falls, NY

Income term products are quite new, so there is opportunity for much innovation, and products will likely take different forms. For instance, payments could be designed to continue for a predefined number of years, regardless of when the insured dies, instead of ceasing at the end of the term period. Or, the death benefit payments could be designed to be contingent upon the beneficiary's survival.

Regarding taxation, life insurers are counseling individuals to seek tax advice from qualified professionals, since a portion of the death benefit payments from these policies may be subject to income tax.

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