

rethink.

Safeguarding Universal Life: Turning Flexibility into Long-Term Confidence

Universal life (UL) insurance can be a powerful solution for Clients who want greater control over how the policy is managed and tax-advantaged[1] growth opportunities. Additional deposits may not be required for a period of time when the policy's fund value is sufficient to cover policy charges. The minimum annual cost of insurance is also typically lower than a participating life insurance for the same initial death benefit.

But with flexibility comes responsibility. Premium flexibility, investment performance and cost-of-insurance charges can interact in ways that may put the policy at risk. Selecting an appropriate investment mix, monitoring performance and adjusting over time can also feel complex and time-consuming. These factors can create uncertainty for both Clients and advisors.

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The hidden risks in Universal Life

At the heart of that concern is underfunding risk: the risk that the policy's fund value may no longer be enough to support ongoing charges. The policy owner may then face a difficult choice: contribute additional money, reduce insurance coverage or risk a policy lapse.

It is one of the less visible risks in a universal life policy because it usually happens gradually. In the early years, the policy's fund value may look strong enough, especially when premiums are being paid. Over time, however, rising cost-of-insurance charges, weaker investment returns and withdrawals can erode the fund value.

Weaker returns can be especially damaging when they occur early in the policy's life. This is what we refer to as sequence-of-returns risk. The policy will have a smaller fund base from which to grow, reducing the benefits of compound interest and making it harder for the policy to cover future charges.

The cost-of-insurance structure also matters. Yearly renewable term (YRT) charges can help generate a stronger fund base in the early years because more of the premium may be available for investment. However, these charges generally increase as the insured ages, which can place more pressure on the policy's fund value over time. With level cost of insurance, the charge is more predictable, but for the same level of premium, less money may be available to build the fund value in the early years. In both cases, the key question is whether the policy has enough stable value to support ongoing insurance charges.

A two-part funding strategy

This is why a thoughtful funding strategy is key and can help reduce much of that fear and burden. One practical and simple approach is to structure the policy fund around two distinct components:

- **A safeguard component:** Allocate enough premium to a stable investment option to support future cost-of-insurance charges. These recurring charges must be paid regardless of how markets perform, making them the priority.
  - Sunlife Diversified Account (SLDA) can be a suitable option. The account is designed to help provide stability within a universal life policy. Similar to a par fund, it is heavily invested in low volatility assets and uses a smoothed portfolio asset yield. It can never have a negative return.
- **A growth component:** Allocate the remaining premium to growth-oriented investments that align with the Client's risk profile.

Together, these two components can help to create a more resilient policy and simplify ongoing policy management. It reduces the need to rely on strong equity returns to keep the policy on track, while preserving the opportunity for long-term growth. With a component specifically designed to support recurring insurance charges, advisors may also spend less time adjusting the strategy in response to short-term market fluctuations.

To maintain the effectiveness of this approach, it is important to preserve the role of each component. If a Client needs liquidity, the component from which a withdrawal is made can affect policy sustainability. A withdrawal from the growth component leaves the safeguard component intact, while a withdrawal from the safeguard component may increase underfunding risk.

[1] Subject to applicable tax rules and policy limits.

Testing the policy's resilience

This approach also reframes the policy design conversation. Rather than focusing on how much growth the policy could generate, it asks a more durable question: **"How resilient is the policy if returns unfold differently than expected?"**

Answering that question requires looking beyond a single estimated return as actual market performance rarely follows a straight line. Monte Carlo simulations can help provide a broader view by randomly modeling hundreds of possible return paths – some strong, some weak, some volatile. By testing the policy across a wide range of market conditions, advisors can better understand how the policy may perform when returns differ from expectations. The results help illustrate how often a policy may become underfunded.

Illustration

Consider Richard, a 60-year-old business owner with a private corporation. He is looking for $2 million of universal life coverage and plans to contribute $120,000 per year for 10 years.

Assumptions:

- The Sunlife Diversified Account is used as the safeguard component, with an assumed 4% rate of return and no withdrawal during the policy lifetime other than to pay for yearly cost-of-insurance.
- Equity is used as the growth component, with an assumed 6% rate of return and 15% volatility.
- The Sunlife Diversified Account return is held flat across the modelling, while 500 equity return scenarios are tested.

A safeguard approach estimates that 81% of Richard's annual premium should go to the Sunlife Diversified Account to help support future cost-of-insurance charges. The remaining 19% can be invested in equity for long-term growth potential.

100% to equity

22%

of 500 scenarios lapse due to underfunding

50% to SLDA
and
50% to equity

4%

of 500 scenarios lapse due to underfunding

81% to SLDA
and
19% to equity

0%

of 500 scenarios lapse due to underfunding*

*It is important to note that a 0% result means no lapses occurred in the scenarios tested. It does not guarantee the policy can never lapse.

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If the assumed Sunlife Diversified Account rate of return is reduced to 3%, the safeguard allocation would increase to 90%, leaving 10% for equity. Similarly, a higher premium would allow a higher proportion to equity.

The safeguard allocation should be viewed as case specific. The results are sensitive to the assumptions selected. Different assumptions may produce materially different outcomes. A different age or cost of insurance method could also lead to a different asset allocation.

Key takeaway for advisors

Universal life is a compelling solution for the right Client, but its value depends on intentional design. A safeguard strategy provides a simple framework to improve policy resilience by focusing on funding the cost of insurance. Such a strategy can help make universal life easier to explain and manage over time.

Ask your sales representative about our UL safeguard tool to help you assess underfunding risk and support a more informed asset mix discussion.

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This article and the results shown are for informational purposes only and are based on the assumptions, inputs and modelling methodology used in the safeguard tool. The modelling does not assess the tax implications of the proposed allocation strategy or other factors such as charges, administrative processes or contractual provisions, including tax-exempt testing requirements, activity accounts, surrender charges, administrative charges and transaction timing. Illustrated values and outcomes are not guaranteed, and actual results may differ materially. The results should be read together with the corresponding product illustration and do not replace professional tax or legal advice.

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