



Death-in-service payments

A professional trust solution to death-in-service payments.

Administering death-in-service (DIS) payments can provide a practical problem for trustees of pension schemes. It is common for many of these DIS funds to be held for a minor beneficiary. During the minority of the child it is relatively common for the DIS to be put into trust and therefore a workable solution is required. It is important that a professional independent trustee experienced in such trusts is appointed.

When the employee dies in service

On commencement of employment the pension scheme member will usually complete a nomination form indicating to whom they would like the scheme trustee to pay the lump sum. This form is not binding however and the trustee of the pension scheme will make the final decision as to how any discretionary lump sum is to be distributed. This discretionary power is provided by the pension scheme trust deed. In most cases the trustee will honour the member's wishes, but they have a duty to exercise their discretion in a fiduciary manner and will therefore need to ensure that the funds are paid properly.

In using their discretion the trustee will take into consideration the following:

- The member's wishes;
- personal and financial circumstances of the member; and
- anyone who may have been financially dependent on the member when they died.

Frequently pension trustees would exercise their discretion in favour of the surviving spouse. However, increasingly complicated family circumstances make the application of funds more difficult as there is a need to ensure they have given full effect to a decision, especially when it involves a payment to minors. When dealing with modest sums for minors, scheme trustees will usually prefer to make a payment directly to the surviving parent or guardian who can then oversee the distribution of funds during the minority of the child or children, or when they attain age 18 although this is not always possible. Scheme trustees may be made aware of circumstances which lead them to adopt a different

approach such as a family conflict or a strained relationship with the employer, which will make it difficult to release funds directly to family members if there is a risk that the funds will not be used as intended. Larger sums can also drive the need for someone independent to be involved because of concerns over conflicts of interest and the security of the underlying assets, which increase the risk of the company or scheme trustees being criticised in the future for the manner in which they exercised their discretion.

Appointment of Trustee

It is at the creation of a formal trust where consideration should be given to the appointment of a professional independent trustee who is external to the pension scheme and can suitably manage the funds on behalf of the beneficiaries. Pension scheme trustees often assume that this is a difficult process but the creation of a trust for an individual is usually simple and straightforward. The difficulty is finding someone suitable, capable and willing and with sufficient experience to act as trustee. The role of a trustee is an arduous duty and should not be taken lightly. As a minimum, a suitable trustee would be expected to devise an investment strategy, deal with the ongoing tax compliance, and keep in contact with the beneficiaries and consider their ever-changing needs. Moreover, they will also have to face up to the practicalities of tracking and accounting for income and capital payments and the review and monitoring of appointed investment managers. These onerous tasks are reasons that the appointment of a professional trustee is preferable, although that approach is not without its own challenges. There is no doubt that professional trustees possess the systems and technical expertise to manage death benefit trusts. However, many professional trustee businesses set high minimum asset value thresholds with minimum fees for private client work, which can have a disproportionate effect on the trust assets. It is particularly important when appointing a trustee that the issue of fees is considered to ensure that the value of the trust is not eroded unduly by professional fees. So what approach can a pension scheme trustee take to ensure that either they or the sponsoring company avoid criticism over the way payments are handled? The answer is to undertake due diligence before appointing a trustee. Simple questions and analysis will undoubtedly avoid problems in future.

For example:

- Understand fee structures and the professional trustee's approach to managing the trust assets. Fees will obviously deplete the value of the trust so it is important to understand whether they are fixed or variable and whether circumstances may arise where additional fees will need to be charged;
- Review the approach to investment. Are investments managed in house or is that function delegated to third parties?
- To what extent will the trustee monitor the investments and adequately review the investment managers and strategies in place?
- It is also important to understand the processes and procedures that will be employed by the trustee. Sufficient controls around record keeping and reconciliation will ensure that trust assets are always accounted for in a timely and accurate manner.

The pension trustee should also contrast what a professional can offer with the appointment of a lay trustee. Lay trustees may not charge fees which can be an advantage for smaller payments but equally it is unlikely that they will have the knowledge of the professional. In addition, do they have an awareness of their fiduciary responsibilities to ensure that the trust is run properly?

Also, can they sufficiently distance their role as trustee from their relationship with the beneficiary? Could they come under undue pressure to release assets and can they really make clear decisions without personal opinions or emotions coming into play?

Fortunately decisions around the appointment of a trustee are now easier as some professionals offer a cost effective solution specifically designed to cater for smaller settlements. These businesses are invariably based around efficient systems and working processes, and an integrated investment solution which allows the business to support the management of these types of trust without any compromise in terms of technical expertise and experience. As a result, the pension scheme trustees have at their disposal a professional trust solution. This allows them to exercise their discretion with more flexibility while at the same time limiting their future risk by ensuring that lump sum payments settled in trust are secure and managed professionally and in the best interests of the beneficiaries.

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