Guide to trusts

We have written this guide to explain how trusts work for AIG life insurance policies. We cannot advise on whether putting a life insurance policy into a trust would be suitable for your particular circumstances and would recommend that you take professional legal advice on this. This guide does not cover AIG Business Protection policies – please refer to our Business Protection – 'Guide to Trusts'.

This guide only explains how trusts work in England and Wales; it does not cover trust law in Scotland or Northern Ireland. This does not mean that AIG trusts cannot be used in Scotland or Northern Ireland but it does mean that the law of England and Wales will apply to any such trusts. In light of this, if you are resident in Scotland or Northern Ireland, you may wish to take your own legal advice on the suitability of our specimen trust documents for you.

Trust law may be subject to change in the future. AIG Life Limited cannot be held responsible for any information given or any changes in tax provisions or legislation that may affect the life insurance within a trust, the tax treatment of it, the provisions of a trust, or the rules applying to gifts for Inheritance Tax planning purposes.

What is a trust?

A trust is a legal arrangement. It allows the owner of property (the settlor) to transfer legal, and/or beneficial, ownership of that property to other persons or a company (the trustees). The person or company receiving the property holds onto it for the benefit of third parties (the beneficiaries). These roles are explained in more detail below.

Why use a trust?

The reasons for putting a life insurance policy into a trust include:

1 The settlor can direct who benefits and how

When a trust is set up, the settlor lists all the people they want to be able to share in the benefits payable under the life insurance policy that is subject to the trust. The settlor can even indicate what proportion of the money they would like each individual to receive - for example John 25%, Jane 25% and Mark 50%.

Without a trust, the benefits payable under the policy would be payable to the settlor's estate and he/she would need to leave directions under the terms of his/her Will to ensure the benefits pass to the people and in the manner intended.

2 Beneficiaries can receive policy benefits more quickly

If a life insurance policy is written in trust, it is no longer part of the settlor's estate. So if they die, the trustees claim on the policy and the death benefits are paid directly to the trustees.

If a life insurance policy is not written in trust, the benefits payable on death are payable to the settlor's estate if they die during the policy term. This means a grant of probate, or letters of administration if the deceased had no Will, would be needed before the insurance company could pay out any money to the deceased's personal representatives. This can take several months.

3 Asset protection

If a life insurance policy is written in trust, the benefits payable under it may be protected from third party creditors or anyone with a claim on the settlor's estate.

4 It can mitigate Inheritance Tax

If covers under a life insurance policy are written in trust, the value of the benefits payable under them are not included in the settlor's estate for Inheritance Tax purposes when the settlor dies (as long as neither the settlor nor his estate or personal representatives are a beneficiary).

There is therefore no Inheritance Tax to pay when the settlor dies in relation to any benefits held in the trust. However, if the money is kept in the trust past its tenth anniversary, some Inheritance Tax may be payable and a charge could arise when money leaves the trust.

Please note: Any benefits that are retained by the settlor and not gifted into trust may form part of the settlor's estate for Inheritance Tax purposes (whether or not that benefit has been claimed).

Before considering a trust, we recommend that you speak to a professional tax adviser who can look at your specific circumstances and explain how Inheritance Tax might affect you as well as any other tax considerations in putting a life insurance policy into trust.

The key people involved in a trust

There are three roles in any trust. These are:

- the settlor;
- the trustees; and
- the beneficiary.

This section explains what these roles are, their responsibilities and their rights.

1 Settlor

The settlor is the person who sets up the trust and transfers assets to it. All AIG trusts are set up using a declaration of trust by the policyholder who themselves becomes a trustee, together with additional trustees who they simultaneously appoint at the outset to administer the trust.

In the case of all AIG trusts, the settlor will normally be regarded as the 'lead trustee' in relation to all aspects of the policy (or covers under it) held in trust. The terms of the trust confer various powers on the settlor including those powers conferred on them as the original policyholder. All AIG trusts (except the AIG Relevant Life Trust) also give the settlor the ability to appoint and remove trustees during their lifetime and those trusts in a discretionary form also permit the settlor to nominate beneficiaries to be added or to be excluded under the trust. In the case of the AIG Relevant Life Trust, these powers are reserved to the life assured.

Under the law of England and Wales, anyone over the age of 18 who is mentally capable can be a settlor.

For a joint life policy, both owners must consent to put the policy into the trust. If this happens they are both settlors of the trust. One of them cannot do it on their own.

2 Trustees

The trustees become the legal, and/or beneficial, owners of the trust property. They must administer the trust in accordance with the terms of the trust document and the law that governs the trust, manage the trust's assets and distribute these (or an income from these) to the beneficiaries when appropriate.

With all AIG trusts, the settlor has to be one of the trustees. There must also be at least one trustee who isn't a settlor. It is recommended (but not mandatory) to appoint more than one additional trustee to ensure that there will always be two trustees to look after the trust. For example, if a couple put their joint life policy in trust, they must have at least one trustee other than themselves. This makes sure that, even if both settlors of a joint life policy die, there is a still a trustee to look after the trust.

It is important to choose the right trustees. They need to have good financial knowledge and be someone the settlor can trust. This could be a friend, a family member or a professional adviser. A professional trustee will usually charge for their services.

It may not be a good idea to ask a beneficiary to become a trustee as this could lead to a conflict of interest.

A trustee should be mentally capable and have a sound financial history. Under the law of England and Wales, a trustee must be over the age of 18.

3 Beneficiaries

The beneficiaries are the people the settlor wants to receive the benefits from the trust. They can have different types of entitlement, depending on the terms of the trust deed. The different types of trust are explained in more detail below.

The beneficiaries will not usually receive anything from a trust holding a life insurance policy until the settlor dies and a payment is made to the trustees. The trustees then look after the money, investing it if necessary, and distribute it amongst the beneficiaries in accordance with the terms of the trust.

A beneficiary can be any age and could be an unborn child, such as a future grandchild of the settlor.

Which type of trust?

AIG offers two forms of trust: a 'bare trust' and a 'discretionary trust.' They each work slightly differently, so if you want to gift benefits under a policy into trust, it is important to choose the type of trust that is right for you.

1 The AIG Bare Trust

A 'bare trust' is the simplest form of trust as the beneficiaries have an immediate right to the trust assets from age 18, and the trustees generally have no discretion or active duties to perform. The trustees act as legal owners of the trust assets until such time as the adult beneficiaries direct them to transfer the assets into their names. The settlor can change the trustees at any time.

The beneficiaries and trust assets each beneficiary is entitled to are fixed at the start of the trust and it is not possible to change this or make additions to the trust.

The advantages of simplicity with this type of trust must be balanced against the lack of flexibility and asset protection for young adult beneficiaries, although the gifted benefits placed in trust will normally only have value when/if the policy pays out in the event of a claim.

2 The AIG Discretionary Trust

The AIG Discretionary Trust is a flexible trust whereby gifted benefits are held by the trustees for a group of potential beneficiaries. The trustees have a discretion to decide which of the potential beneficiaries to benefit under the trust, how much they receive and when.

A 'discretionary trust' is more complex than a bare trust, but has more options and flexibility for a settlor.

The settlor chooses the class of beneficiaries, but because the trust is in a flexible 'discretionary' form, the beneficiaries and their entitlements can be changed once the trust is created, to reflect any change in circumstances of those beneficiaries. This is because the decision as to who benefits, in what amount, and at what time, is at the absolute discretion of the trustees. The settlor can express how and when he would like the trustees to do this by providing an 'Expression of Wishes' document, which is not binding on the trustees.

Having this flexibility means that the trustees can react to the individual circumstances of the beneficiaries at the time the policy benefits become payable; choosing to pay out if the beneficiaries are mature enough, or retain benefits in trust temporarily if the time is not right. It also means that the settlor does not need to fix the beneficiaries' entitlements at the start of the trust, and can update his or her 'Expression of Wishes' whenever circumstances change. The settlor can nominate beneficiaries to be added or excluded at any time, which is useful if the settlor has another child or grandchild. The settlor can also change the trustees.

The trustees have considerable power in a discretionary trust so it is especially important for the settlor to choose individuals whom they trust and who understand their wishes.

Gifting or retaining benefits

All AIG Trusts are drafted so that the settlor is able to split their life insurance policy so that they keep some of the benefits under the policy ('retained benefits') and some are put into trust ('gifted benefits'). Not every life insurance policy can be split but this is possible with AIG's YourLife PLan Life Start and CIC Start policies.

Certain benefits payable under a life insurance policy are designed to protect the settlor's lifestyle. Some of these benefits (e.g. Income Protection) may not be eligible to be placed in trust and so will be automatically retained. Other benefits, such as Care Cover, Critical or Terminal Illness Cover, can be a 'retained benefit' or a 'gifted benefit'.

In both forms of AIG Trust, there is a section which allows the settlor to choose to gift the benefit under the relevant cover. If the appropriate box is not ticked, then this benefit will be retained by the settlor and the benefit payable under the cover will not be paid to the trust.

Joint life policies in trust

Both the AIG Bare Trust and the Discretionary Trust can be used with AIG joint life last survivor policies and joint life first death policies (if appropriate).

Normally, if the aim of placing an insurance policy into a trust is to mitigate Inheritance Tax ('IHT'), the settlor (who has 'given away' the benefit) needs to be excluded as a beneficiary of the trust and the benefits payable on a death claim are held in trust for other beneficiaries. Where two parties take out a joint life policy, they will both be settlors of the trust.

For this reason, it may be appropriate to consider writing two separate policies so that each life assured can write their respective policies in trust and the other can benefit as they have not 'given away' that policy. However, there may be circumstances where a joint life policy is appropriate or where an existing joint life policy is to be placed in trust, so that if both lives die together the proceeds will be outside both estates for IHT purposes, yet if only one life dies, the survivor will benefit.

Therefore, we also provide all our personal trusts on a joint life basis so that where two people take out joint life cover and wish to place all (or part) of it in trust, they can. All these trusts also contain a 'Survivorship Option' to enable the surviving joint policyholder to benefit from the proceeds of a first death joint life policy (if they wish).

Where relevant, the settlors must select the Survivorship Option for any benefits payable on a joint life **first death** policy to be paid to the survivor (if he/she survives the death by 30 days) or to the trust (if the survivor fails to meet the 30 day requirement).

Please note: If the Survivorship Option is **NOT** selected, then any death benefits payable under a joint life **first death** policy will be paid to the trust (not the survivor) regardless of how long the survivor lives after the death.

If the Survivorship Option is selected, the death benefits payable on the first death will form part of the survivor's estate and so the trust may not provide effective IHT mitigation on the survivor's death.

Guide to being a trustee

The duties and powers of a trustee are set out in trust law, as well as in the trust document. Below is a guide to the main trust law duties and powers, but it is also important to read the trust document to make sure you understand the responsibilities that you are taking on. In fulfilling their role, a trustee is also expected to exercise such care and skill as is reasonable in the circumstances and manage the trust assets prudently as if they were the trustee's own assets.

If a trustee fails to comply with the terms of the trust or their duties as trustee, they will be personally liable to make good the financial loss suffered by the trust fund. The liability of a trustee for breach of the trust shall be limited to breaches arising from the trustee's own fraud, wilful misconduct or gross negligence, except in the case of a trustee acting in a professional capacity.

The trustees shall not be liable for the default of a person acting under a delegated power, provided they took reasonable care in the selection and supervision of such person.

1 Duties of trustees

Duty to invest the trust fund

The property in the trust is called the 'trust fund'. A trustee is responsible for making sure that the trust fund is invested and managed for the beneficiaries until the money is distributed. If the only property in the trust is an insurance policy, there will be no fund to invest until the benefits under the insurance policy become payable. At that point, the money will need to be invested and managed until such a time as it is right to distribute it to the beneficiaries of the trust.

Duty to act impartially

If there is more than one beneficiary, the trustees must not act in a way that will benefit one of them over the other. For example, if one beneficiary is to receive income from the trust but another one will receive the capital, the trustees should invest the fund to produce both an income and capital growth. The trustees must act in the best interests of all the beneficiaries at all times.

Duty to take appropriate advice

Trustees should take professional advice before investing the trust fund, unless the fund is so small that the cost of the advice would outweigh any benefit, or one or more of the trustees is qualified to give investment advice. Trustees can ask a professional, such as an investment manager, to act on their behalf in investing the fund, but the responsibility for the investment would still lie with the trustee, so the trustee should keep their appointment under review.

Duty to distribute the trust property

The trustees should ensure the trust fund is transferred to the beneficiaries at the appropriate time, in accordance with the trust deed (e.g. by deed) and before the end of the 'trust period'. All AIG trusts have the statutory period of 125 years from the date of the trust deed, but the trustees are able to (and will almost certainly) distribute the trust assets much sooner.

Duty to keep the trust's property secure

Trustees are responsible for making sure that the trust fund is secure. So, if the fund includes something tangible like a house, they are responsible for making sure that it is insured.

Duty to keep the trust's records

Trustees must keep a record of any decisions they make, actions they take, advice they have taken and any costs the trust has had to pay. They should also keep annual accounts, although these can be very simple if the trust fund consists purely of cash or the right to receive benefits from a life insurance policy.

Duty to not profit from the trust

Trustees acting in a professional capacity can claim reasonable fees for their services, but they must not manage the trust in such a way that they or their firm will get extra work.

2 Trustees' powers

The trustees have a number of powers to enable them to effectively manage and distribute the trust's assets. These are either expressly set out in the trust deed or operate under trust law, including wide powers to invest the trust fund, insure it or borrow against it. The trustees of a discretionary trust also have the power to lend the trust fund to potential beneficiaries of the trust. We recommend that the trustees seek appropriate legal and other professional advice before exercising this power.

The trust document may also set out additional powers, for example, regarding the distribution of trust assets or changing the beneficiaries.

A trustee is able to delegate their administrative duties to an agent or a co-trustee and all AIG trusts give the trustees this power (either singly or jointly). This, for example, would enable them to appoint a fund manager to manage trust assets (if necessary) or for practical reasons, e.g. to delegate all administrative functions to a 'lead trustee' (such as the settlor during his or her lifetime). This is in addition to any other powers already conferred on the settlor by the policy or under the terms of the trust.

Trustees cannot generally delegate their dispositive powers and decisions (including the distribution of trust assets or amendments to the trust terms or beneficiaries) unless they do so formally, usually on a temporary basis, and legal advice would be required.

3 How trustees make decisions

With all AIG trusts, and under general trust law, the trustees should all be in agreement on decisions relating to the trust. So, if most of the trustees want to pay a beneficiary, but one does not, the beneficiary cannot be paid. This is another reason why trustees should be carefully chosen to minimise the risk of conflict. As explained above, most trustee functions (particularly day to day administrative functions) can be delegated to a single trustee, but all the trustees would need to agree to this. Decisions regarding the policy and/or level of cover will in most cases be carried out by the settlor as the terms of AIG trusts permit these powers to be retained by them during their lifetime.

Frequently asked questions

1 Who pays the premiums when a policy is in trust?

Under an AIG trust, it is the responsibility of the settlor to ensure premiums continue to be paid on the insurance policy.

Please note: AIG are not able to provide advice on the tax implications of paying the premiums on a policy that is written in trust and would recommend that you take professional tax advice on this.

2 What happens if a trustee wants to retire?

A trustee can retire provided there would be at least two continuing trustees following their retirement, with a new trustee being appointed to replace the retiring trustee if necessary.

3 Can trustees be removed?

The settlor can remove trustees in certain circumstances, as long as this would not leave the trust with less than two continuing trustees. The continuing trustees can exercise this power after the settlor's death.

A Deed of Appointment and Retirement of Trustee form is provided in the AIG trust section for use with all AIG trusts.

4 Does a trust always need to be written by a solicitor?

You can have a trust written by your solicitor, but many insurance companies, like us, have 'ready-made' adaptable specimen trusts available for the life insurance policies they offer. These trusts are not usually suitable for anything other than life insurance policies.

We would recommend that you take legal advice before setting up a trust, particularly if you have any questions on the application of the trust to your particular circumstances.

5 Is a trust right for me?

The main reasons that people use trusts are set out above under 'Why use a trust?', but a trust is not right for everyone. In particular, if you want to be able to benefit from something that you're thinking of putting into a trust or if you think you might want to have access to it in future, then a trust may not be right for you. It is a good idea to get advice from a financial, tax and/or legal adviser before you make a decision.

6 Does AIG need to see the completed trust deed?

AIG will not need to see the trust deed before the insurance policy starts, but you (or your financial adviser) will be asked to send a copy of the trust deed once it has been executed. We will only need to see the original executed trust deed when a claim is made. If the AIG electronic trust form has been submitted electronically, this record will automatically be retained on the AIG system.

WARNING: Once you have put a life insurance policy or the covers under the policy (e.g. terminal illness) into trust, you are no longer the legal owner and do not have control or any access to it. Even though you have a cooling-off period for a policy you take out with AIG, you do not have a cooling-off period when you set up a trust.

Once you have signed the trust form and the trustees have agreed to act, then you have given away the policy (and any benefits payable under it).

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