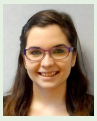
# Life interests and family trusts



"sometimes the structure is more complex"
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Many individuals will ultimately receive an income which is guaranteed to be payable for the remainder of their life. Most commonly this is in the form of a pension, whether it be an annuity purchased from an insurance company, or a pension payable from a defined benefit pension scheme.

Placing a value on future income streams is a key part of the actuarial calculations required to quantify the financial health of a pension scheme. However, there are other circumstances in which similar techniques can be used to value an income stream. One such situation is when an individual needs to be compensated financially for the loss of a life interest in a property.

## What is a Life Interest?

The right to a life interest is usually created in a will and is designed to give a person the benefit of a property for the rest of their life. This benefit can either take the form of the right to live in the property rent-free, or the right to receive the rental income from the property, if it is rented out to another party.

A common example of a life interest is when a surviving spouse or partner has the right to remain in a property for the rest of their life, before it is passed on to the next generation. However, sometimes the structure is more complex and two or more people may each have a life interest.

## Valuing a life interest

A life interest has a value and, with the agreement of all parties involved, it can be exchanged for an immediate capital payment. In practice, this is often done when the property is sold; part of the sale proceeds go to the life interest holder, and the balance, known as the reversionary interest, is paid to the vendor.

In financial terms, the right to live in a property can be thought of as the cost of renting an equivalent property over the same period.

The actual value of the future rental income payments cannot be known with certainty in advance. This is because it is impossible to know at the point the life interest needs to be valued how long the life interest holder will live and at the level of rental income.

In many ways, this is no different from placing a value on future pension payments. Therefore a life interest can be valued by applying the same actuarial techniques used for valuing pension incomes. The information required includes the market value and rental income of the property when the life interest is to be valued. Sufficient information to be able to estimate the life expectancy of the life interest holder(s) is also needed.

## Family Trusts

A life interest in a property is just one example of where actuarial advice is required to place a value on a future income stream. Another area, where we are receiving an increasing number of requests, is in connection with the winding up of family trusts.

Often, the trust's rules will entitle several beneficiaries to an income payable for life. Typically the trust will have been set up many years previously, when interest rates were considerably higher than they are now. As a consequence, the level of income generated by the trust's assets may have fallen to such a level that it is no longer financially viable to operate the trust and still pay the beneficiaries the sort of level of income they had enjoyed in the past.

These cost pressures are prompting some trustees to look at how to distribute the remaining trust assets fairly between the beneficiaries so that the trust can then be wound up. A fair allocation of the trust's assets will depend on the life expectancies of the beneficiaries and any specific requirements of the trust.

The income of each beneficiary is likely to depend on how many are alive at a particular point in time and whether they have any heirs who would continue to benefit from the trust after their death. Therefore a bespoke model needs to be developed to reflect the provisions of an individual trust. This model can then be used to illustrate the sensitivity to each beneficiary's share of the trust's assets to changes in the modelling assumptions.

Life interests and family trusts are just two examples of where actuarial advice may be required outside of the more traditional areas of actuarial work in pensions and insurance.

BWCI has considerable experience in providing bespoke advice as an expert actuarial adviser in relation to life interests and family trusts and are able to provide certification of the allocation of the assets in a variety of scenarios.

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