

What Is a Discretion?

Trustee boards will often need to exercise their powers of discretion when administering their pension plan.

Not all powers are discretionary, though, and it is important to understand the difference between a duty and a discretion. The key characteristic of a discretionary power is that it is something that trustees have the power to do, but are not required to do. Discretionary powers are typically expressed in terms of what the trustees “may” or “have the power” to do – as opposed to a duty, expressed as what they “shall” or “must” do.

The decision-making process is often complex, but there are a number of principles that will apply to all discretionary decisions, whatever the circumstances.

What Discretionary Powers Do Trustees Have?

The powers that are at the discretion of the trustees will vary between different pension plans, but they will typically include some or all of the following:

- Distribution of lump sum death benefits
- Granting ill-health early retirement pensions
- Augmenting benefits
- Reducing, suspending or terminating benefits in accordance with the plan’s rules
- Setting actuarial factors
- Granting non-statutory transfers or trivial commutation
- Settling benefits for children under age 18

The exact scope of the discretionary powers granted to the trustees will also vary from plan to plan. Some discretionary powers will have additional requirements attached to them before the trustees can exercise their discretion – such as the consent of the sponsoring employer or a requirement to consult the plan actuary. Before starting the decision-making process, trustees should check their plan’s rules to understand what powers apply. If you are unsure of what your powers are, check with your legal advisers.

What Are the Legal Requirements?

When considering how to exercise a discretionary power, trustees should follow the following basic rules. Depending on the circumstances, some of these steps will be more complex than others.

Do...	Don't...
Do check your plan’s rules and ensure you understand the nature and scope of your powers before taking any action. Consult your advisers if necessary	Don't rush into taking a decision until you have got everything you need to know. Take your time (but DO ensure that discretionary lump sum death benefit decisions are made within two years of the members’ death)
Do take into account all relevant information when exercising your discretion	Don't base any aspect of your decision on irrelevant information
Do make appropriate enquiries and ensure you have all the facts before making a decision. When considering a lump sum death benefit distribution, identify all potential beneficiaries and enquire about their financial and other circumstances	Don't blindly follow any nomination form made by a member when considering a lump sum death benefit distribution – look at all the relevant facts
Do act for the proper purpose, i.e. exercise discretionary powers for the purposes of the trust and for the purposes for which the powers were given. This usually means acting in the best interests of the plan’s membership as a whole but can include taking account of the employer’s interests	Don't bind yourself as to the outcome of future discretionary decisions – each exercise of your discretion must be taken separately
Do reach a decision that is reasonable in all the circumstances. Often there is more than one possible outcome that is reasonable	Don't treat some members unfairly (which does not necessarily mean that you must treat all members equally)

What Are the Consequences of Failing to Comply?

Where trustees have exercised their discretion on a matter, the decision can be challenged by pension plan members or their beneficiaries. However, there is a high standard required for a complaint to succeed.

In particular, the powers of the Pensions Ombudsman are limited in relation to discretionary powers. The Ombudsman may require trustees to reconsider a discretionary decision where they have failed to follow due process, or reached a decision that no other group of trustees, acting reasonably, could have taken. (The latter scenario is especially difficult to establish – it is not sufficient to be able to claim that a different group of reasonable trustees would have reached a different decision.)

However, even where the Ombudsman does have the power to step in, they cannot set aside a discretionary decision – they can only order the trustees to reconsider the matter (which may result in the same decision being taken).

Some Practical Points

Do...	Don't...
Do keep complete records of the decision made and the reasons for it	Don't allow the sponsoring employer or other third parties to dictate how you exercise your discretion (but Do obtain the employer's consent where the plan rules require it)
Do take professional advice in complex cases	Don't automatically provide your reasons for reaching a certain decision – think carefully about the appropriate amount of detail that you disclose and take legal advice if you are unsure

Contact

Kirsty McLean

Partner, London

T +44 20 7655 0298

E kirsty.mclean@squirepb.com