Bankruptcy and Superannuation

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I. Introduction

Since before federation Australian Parliaments have sought to "encourage thrift and induce a man to provide for his own, so that they may not become a burden on the State".[1] This encouragement included legislation which protected certain forms of long term investment such as life assurance and endowment assurance from creditors. Early examples of such protection are the *Life Assurance Encouragement Act 1862* (NSW) and the *Life Assurance Companies Act 1901* (Qld). These sorts of protective provisions have found their current expression in sections 92 and 94 of the *Life Insurance Act 1945* (Cth). The protection in that Act however is expressed to be subject to the provisions of the *Bankruptcy Act 1966.*

The legislature has been slow to extend a similar form of protection to superannuation. This may have been because superannuation has been regarded, traditionally, as an asset beyond the reach of a trustee in bankruptcy. However, recent decisions and amendments to statute have radically changed the old law.

This paper will consider the interaction between bankruptcy law and superannuation funds at three different levels. The first issue is whether or not a bankrupt's interest in a superannuation fund is "property" capable of vesting in a trustee in bankruptcy. This involves consideration of the nature of a member's interest in a superannuation fund and also the validity of forfeiture provisions included in superannuation deeds. The second area which will be considered is the scope of the new specific exclusion of superannuation and similar investments from the operation of the Act. Finally, the paper will briefly consider the extent to which payments into or amendments to a superannuation fund could constitute antecedent transactions which could be set aside by a trustee in bankruptcy and

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1 *In Estate of Adams* (1894) 15 LR NSW B & P 135 at 151 per Manning J.

the extent to which income from superannuation funds falls within Division 4B of Part 6 of the *Bankruptcy Act.*

II. Superannuation as an Asset in Bankruptcy

A superannuation fund is a trust and as with any other trust the interest of a member in it is the equitable interest of a beneficiary.

On bankruptcy all property of a bankrupt vests in his or her trustee in bankruptcy.[2] This includes a bankrupt's beneficial interest in a trust whether the interest is a presently vested interest or a contingent future interest.[3] The property vested in the trustee even includes the right the bankrupt has to compel a trustee to properly administer a trust, the "right of due administration".[4]

It does not include a mere expectation such as an entitlement under a will where the testator is still living[5] or the possibility of receiving a distribution from a discretionary trust.[6] Consequently the discretionary trust has been the instrument of a great deal of bankruptcy planning. The difficulty with this sort of planning is that the bankrupt loses control of his assets although attempts are normally made in discretionary trust deeds to grant him some powers such as the power to replace the trustee or the power to add or remove objects (potential beneficiaries) to the trust. Such powers will not be property available to creditors on a bankruptcy if they, from a legal point of view, cannot be exercised by the bankrupt for his own benefit. Trust powers normally have to be exercised for the objects (beneficiaries) of the trust and a power to add or remove trustees has been held not to be property for the purposes of bankruptcy.[7]

The issue, then, is whether a bankrupt's interest in a superannuation fund is a future contingent interest which can vest in the trustee in bankruptcy or whether it is a mere expectancy which does not vest.

The position in relation to each deed will turn very much on the particular terms of that deed, although in drawing a deed many terms are dictated by the nature of the regulatory scheme for superannuation, the "SIS" scheme.[8]

In *Re Coram*[9], a South Australian Federal Court decision, O'Loughlin J held that the bankrupt's interest in a particular superannuation fund was a mere

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2 Sections 58 and 116(1); and definitions "property" and "the property of the bankrupt" in s 5.

3 *Davidson v Chalmers* (1864) 33LJ Ch 622; *Re Coram; Ex Parte Official Trustee in Bankruptcy v Inglis* (1992) 36 FCR 250.

4 *Official Receiver in Bankruptcy v Schultz* (1990) 96 ALR 327.

5 *Johnson v Smiley* (1853) 17 Beav 223.

6 *Re Weir's Settlement Trusts* (1971) Ch 145.

7 *Dwyer v Ross* (1992) 34 FCR 463.

8 The legislation which currently regulates superannuation is the "SIS Scheme", a package of seven acts passed in 1993 effective from 1 July 1994, the most important of which is the *Superannuation Industry (Supervision) Act* 1993. This replaces the previous scheme imposed by the *Occupational Superannuation Standards Act* 1987, the "OSSA Scheme".

9 *Supra* n.3.

expectancy prior to resignation, but after resignation it crystallised into a future ascertainable interest which could vest in the trustee in bankruptcy. The particular clause read:

> A member who resigns or is retrenched before the early retirement date shall be entitled to a deferred benefit.[10]

In other words, O'Loughlin J considered that on the wording of the particular deed he was considering the bankrupt's interest in the deed prior to resignation or retrenchment was similar in nature to the interest of a beneficiary under a discretionary trust and was not "property". His comments however are not limited to the terms of the particular deed he was there considering but purport to be a general statement. The relevant passage reads:

> Historically, a superannuation fund was a form of trust that an employer established for the benefit of his employees ... The employee was only entitled to a benefit upon retirement; thus he would not necessarily receive any part of the amount allocated to the credit of his account if there was an early resignation or a dismissal. The emphasis on the benefit maturing upon retirement also emphasised that until retirement the member's rights to or interest in any benefit were inchoate and would not crystallise until retirement (or earlier death). Even though the benefits afforded through superannuation funds have improved materially over the years - in particular it is common place for some benefit to vest upon premature retirement and for provisions to cover illness and injury - the inchoate nature of the member's rights or interests have remained unaltered. Until the happening of a prescribed event that will crystallise his right into an actual entitlement, a member of a superannuation fund is neither the legal nor the beneficial owner of the amount that stands to the credit of his account from time to time.[11]

The consequence of His Honour's finding is that no part of a benefit in a superannuation fund will vest in a trustee in bankruptcy for distribution amongst creditors whilst the bankrupt's interest remains an amount to his credit in an account rather than an actual entitlement.

In order to understand the effect of the decision it is useful to consider the sorts of usual terms contained in a superannuation deed under the current regulatory scheme. A sample superannuation deed appears in paragraph 18-481 of the CCH *Australian Superannuation Law and Practice* although this deed appears to have been drawn to satisfy the previous OSSA provisions rather than the current SIS scheme. The effect of the deed is to establish an account known as a "member's reserve" in the name of each of the members, the value of which is established in accordance with the provisions of the deed. The provisions of the deed avoid stating that the member has any interest as a beneficiary or has a propri-

10 At page 251.
11 At page 253.

etary interest in any property held by the trustee. The language is similar to that which would be used for the establishment of a bank or investment account. Rule 7 which is typical of the provisions dealing with payment of benefits to members states that upon termination of employment:

> The benefit payable shall be equal to a proportion of the member's reserve at the date of his ceasing to be in the service of the employer.

Different rules apply to work out the precise benefit under the deed depending on the manner of termination and whether it is before or after age 55.[12] The wording of a modern superannuation deed is not inconsistent with a member's interest being a mere expectancy prior to the happening of some entitling event such as resignation but the Act and regulations do not help a great deal in ascertaining the precise nature of a member's interests. The definition of "beneficiary" in s10 of the Act includes "a person who has a beneficial interest" but to use this to determine what the beneficial interest consists of would be begging the question. The "minimum benefits standards" in the regulations speak of a requirement that a member be entitled to "cash" benefits on the happening of certain events, such as attaining age 65. Significantly, Regulation 6.21 says that the benefit *must* be paid on the member attaining:

- 65 if not in employment
- 75 if not in full time employment.

Because of this requirement of vesting at a future time it is difficult to see how an interest in a superannuation deed prior to resignation is anything less than a contingent interest similar to the interest of a residuary beneficiary under a Will. A residuary beneficiary under a Will does not obtain any particular interest in property comprising a deceased estate until the estate has been fully administered but the interest of a residuary beneficiary as noted above, passes to a trustee in bankruptcy upon the death of the testator. How then, is a superannuation fund different? A discretionary trust does not give rise to a beneficial interest capable of passing to a trustee because the entitlement of a beneficiary is subject to the exercise by the trustee of a discretion. The superannuation legislation requires benefits under a superannuation deed to be "cashed" at certain specified ages. It would seem that any provision in the deed giving a trustee a discretion not to pay an entitlement would be in breach of this provision. Typically, superannuation deeds do not give the trustee a discretion but rather provide that payment will only be made on specified events. With the greatest respect to O'Loughlin J, it would seem strongly arguable that the date upon which a member

12 The circumstances in which benefits are paid are now governed by regulations 5.05 and 5.06 and Schedule 1 of the SIS regulations known collectively as the "minimum benefit standard".

is accepted into a superannuation fund the member obtains an immediate future equitable interest.

This view is consistent with the reasoning of Gummow J in the *Bond* Full Court decision.[13] His Honour was considering a fund similar in form to the sample fund mentioned above and concluded:

> *Upon the constitution* of the fund Mr Bond obtained an equitable proprietary interest in the fund, albeit one which did not carry an immediate right to payment. (emphasis added)[14]

If this view is correct then as soon as a member of a superannuation fund becomes bankrupt the member's interest in that fund automatically vests in his or her trustee in bankruptcy. The happening of the entitling events, such as achieving a particular age, are not crucial to the vesting although the trustee in bankruptcy will, of course, receive no better entitlement to payment out of the fund than the bankrupt himself. In other words, although the interest in the superannuation fund may vest immediately on bankruptcy, if the bankrupt himself would not be entitled to a payment until age 55 then the trustee would also not be entitled to a payment until the bankrupt achieves age 55. Discharge of the bankrupt will have no effect on the trustee's entitlement to follow this vested property interest although the specific limitation provisions of the *Bankruptcy Act* probably prevent a trustee in bankruptcy from making a claim after 20 years from the date upon which a person became a bankrupt.[15]

III. Forfeiture

Superannuation deeds in the past have commonly included a clause headed "forfeiture" designed to exclude a bankrupt member from participating in any benefit. It has generally been assumed because of this clause that interests under superannuation funds do not vest in trustees in bankruptcy. This assumption was shown to be incorrect in the well known *Bond*[16] decision. The specific provision considered in that case read:

> If a person entitled to a benefit under this deed or the rules becomes bankrupt or insane or is in the opinion of the trustees incapable of managing his own affairs then that benefit shall immediately be forfeited to the fund.

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13 *Caboche and Anor v Ramsay and Ors; Bond and Ors v Ramsay and Ors* unreported Full Federal Court Ryan, Gummow, Lee JJ 13 December 1993 Judgment number 920 of 1993.
14 At page 27.
15 Section 127(1).
16 At first instance *re Bond ex parte Ramsay* 1992 ATC 4807, Court of Appeal decision (supra).

The importance of the *Bond* decision has now been reduced by the enactment of section 302A of the *Bankruptcy Act.* That section reads:

> "**302A(1) [Application]** This section applies to a provision in the governing rules of a provident, benefit, superannuation, retirement or approved deposit fund to the extent to which the provision has the effect that:
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> (a) any part of the beneficial interest of a member or depositor is cancelled, forfeited, reduced or qualified; or
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> (b) the trustee or another person is empowered to exercise a discretion relating to such a beneficial interest to the detriment of a member or depositor;
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> if the member or depositor:
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> (c) becomes a bankrupt; or
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> (d) commits an act of bankruptcy; or
>
> (e) executes a deed of assignment or a deed of arrangement under this Act.
>
> **302A(2) [Provision void]** The provision is void.
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> **302A(3) [Time period applicable]** This section applies to governing rules made before the commencement of this section.
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> **302A(4) ["governing rules"]** In this section:
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> > **"governing rules"**, in relation to a fund, means any trust instrument, other document or legislation, or combination of them, governing the establishment or operation of the fund."

The section seems to assume that a member of a fund has a beneficial interest in the fund. As indicated above, this is not entirely clear. It is also curious that the section only applies to "provident, benefit, superannuation, retirement or approved deposit" funds. There is no specific mention of funds of life assurance or endowment assurance so it is an open question as to whether these fall within the above words. Finally, it should be noted that the section only applies to bankruptcies commencing on or after 1 July 1994. Consequently there is still some work to be done by the *Bond* decision.

In that case both Hill J at first instance and the Court of Appeal held that the forfeiture provision was void. The decision was not based on the bankruptcy principle of "relation back" but rather on an old principle of trust law rendering void restrictions on alienation of an absolute interest. The principle is stated as follows in an article on the subject quoted by the Court of Appeal:

> If property is given to A for life *provided* he does not alienate or become bankrupt the condition is void and an alienation by A is valid, and on his bankruptcy the interest passes to the trustee in bankruptcy. But if property is given to A *until* he shall alienate

> or become bankrupt, an attempted alienation by A, or his bankruptcy, terminates his interest, and nothing passes to the transferee or trustee in bankruptcy.[17]

As pointed out in the Court of Appeal decision, the standard "forfeiture" clause is phrased as a void forfeiture rather than a gift "until" bankruptcy. Accordingly it is quite clearly void. An expression in the vesting provision making it "subject to" the terms of the deed was not sufficient to change it from a void restriction on alienation to a valid conditional gift.

It is important to note however that the effect of these cases is to strike down a clause which is a subsequent restriction on alienation. Although the decisions contain some discussion of the circumstances in which a clause might be valid, where it uses the word "until", this discussion is merely obiter dictum. It is quite possible that a subsequent court may decide that even if the usual "forfeiture clause" is redrafted so that it uses the wording of a conditional gift it will nevertheless be void. The learned author of the article mentioned above stated:

> Whether a gift of an estate in fee simple in land, or of ownership of personalty, *until* alienation or bankruptcy is valid is a question that cannot yet be regarded as settled.[18]

In other words to redraft a deed in order to make it clear that an interest does not flow to a member after their bankruptcy, it may be necessary to not only redraft the forfeiture provision but also to redraft the vesting provision.

One of the arguments in the *Bond* decision which failed was that the vesting provision in that deed required the bankrupt to apply to the trustee for a benefit. The Court held on the construction of the deed that no such application was necessary but there is no reason, subject to the legislative scheme, why a requirement for an application by a member to the trustee could not be made a prerequisite of payment. Two requirements in the scheme which would need to be taken into account when redrafting any superannuation deed. The first is the "sole purpose" test which requires superannuation funds to be for the sole purpose of, stated shortly, providing superannuation benefits.[19] The second legislative requirement which the fund would need to satisfy is the absolute requirement that interests in a fund must be "cashed" upon the member attaining the age of 65 or 70 and not being employed as mentioned in the legislation.[20] It would not be possible to redraw a superannuation deed as a true discretionary trust but it may be possible to make some benefits under a superannuation deed conditional upon a decision of a trustee. These sorts of provisions are made void by s302A(1) (b), if that section is applicable. If applicable, however, it may not catch a clause of general wording rather than one specifically directed to bankruptcy.

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17 "Hall v Bust" by WN Harrison (1961) 35 ALJ 3 at 5 quoted by Gummow J in *Bond* at 21.

18 At page 5.

19 SIS Act s62.

20 SIS Regulations 6.21(1).

One attempt to redraft the forfeiture provision which is clearly ineffective is the amendment of deeds making forfeiture occur upon an act of bankruptcy being committed rather than a member becoming bankrupt. This kind of amendment was considered in *Bond* itself at first instance. Hill J thought that if the clause in that case had been read to mean forfeiture on an *act* of bankruptcy this would not have made any difference to its invalidity.[21]

A further note of caution in amending deeds to try and make them more "bankruptcy proof" is that sounded in the first instance *Bond* decision as to the circumstances in which amendments to a deed will be void. Any amendment to a deed which would have the effect of altering beneficial interests could be void[22] and may, indeed, have stamp duty or capital gains tax consequences. These sorts of problems will not arise if O'Loughlin J's analysis is correct and Gummow J's analysis is incorrect and a member does not have any future contingent interest in a fund but merely an expectancy until the date of an entitling event.

In summary, the forfeiture clauses in many superannuation funds will be void either generally or under s302A and the interests of members in those funds will vest in a trustee in bankruptcy upon a member's bankruptcy subject to the protective provisions mentioned below.

IV. The Old Protective Provisions

As a matter of public policy, certain property is specifically excluded from the property which vests in a trustee in bankruptcy and is available for distribution to creditors. This includes such property as a means of transport which does not exceed the value of $2,500 and proceeds of a bankrupt's personal injuries claims.

Before 1993 protection was given to policies of "life assurance" or "endowment assurance" in respect of the bankrupt which had been in force for two years. Policies of "pure endowment" were also protected but only if they had been in force for four years.[23]

The Full Federal Court has recently considered the meaning of these old terms[24] and their findings can briefly be summarised as follows:

1. Life assurance is a policy whereby an amount is payable upon the death of a person, either generally or within a specified period;
2. Endowment assurance is a policy whereby an amount is payable if a person survives to a particular date;

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21 At 4818.

22 At 4821.

23 Section 116(2)(d) pre the *Superannuation Industry (Supervision) Consequential Amendments Act 1993* (Act No. 82) the relevant part of which commenced on 1 July 1994.

24 *NM Superannuation v Young* (1993) 41 FCR 182.

3. A policy of pure endowment is a policy which is solely of endowment assurance and has no life assurance element.[25]

Earlier decisions show that these terms do not encompass insurance policies covering such events as accidental injury. Difficulty arises in fitting a policy under one of the old headings where, as with most modern superannuation policies, it is a composite of life assurance, endowment assurance and accident insurance. The characterisation of such a fund under the old headings has not been resolved although it would appear consistent with existing authority that such a policy is "life assurance" provided it has some provision giving a contingent benefit upon death. The fact that this benefit may not exceed employer and employee contributions plus interest is not a bar to it being "life assurance".

V. The New Protective Provisions

As of 1 July 1994 the nature of the protective provisions changed for all bankruptcies on or after that date so that there is now specific reference to superannuation. The new exemption extends to:

(i) Policies of life assurance or endowment assurance in respect of the life of the bankrupt or the spouse of the bankrupt;

(ii) The proceeds of such policies received on or after the date of the bankruptcy;

(iii) The interest of the bankrupt in:—
  A. a regulated superannuation fund (within the meaning of the *Superannuation Industry (Supervision) Act 1993*); or
  B. an approved deposit fund (within the meaning of that Act);

(iv) A payment to the bankrupt from such a fund received on or after the date of the bankruptcy, if the payment is not a pension within the meaning of the *Superannuation Industry (Supervision) Act 1993*.[26]

There is now no limitation *in time* as to when the policy was taken out subject to the antecedent transaction provisions mentioned below. There is however a limitation *in amount*.[27] The protection only extends to the property in as far as it "does not exceed the bankrupt's pension RBL (worked out under section 140ZD of the *Income Tax Assessment Act 1936*) for the year of income in which the date of the bankruptcy occurred". This amount is *$800,000* for the 94–95 year and for subsequent years it is indexed. Division 3 of the rules[28] now deals with how the

25 *Ibid.* at 201 per Hill J.
26 Section 116(2)(d).
27 Section 116 (5)–(9) inclusive.
28 Rules 41–416.

value of property of the fund is determined where the value of the fund *exceeds* the "pension RBL".

The rules provide for the "withdrawal benefit" of the bankrupt to be ascertained by an actuary. The trustee of a bankrupt must give a request in writing to a trustee of a fund to provide details of, amongst other things, the value of that withdrawal benefit[29] and the trustee of the fund must then provide the information required *within 28 days* or within such further period as the trustee (in bankruptcy) may grant by way of extension.[30]

Generally speaking, where there is property over the $800,000 limit the property subject to the most recent preservation of benefits restrictions will rank ahead in terms of protection of property under less protective provisions with non-superannuation monies coming last. These provisions are, however, complex importing technical terminology used in the SIS legislation and I don't propose to analyse them in detail in this paper.

This new protective provision is a generous concession to debtors and will be of considerable importance in the future.

VI. Payments Into and Variations of Funds

So far this paper has covered whether or not the bankrupt's interest in a superannuation fund vests in a trustee. There is a separate question of whether or not a payment to a superannuation fund is void against a trustee.

It may be possible to challenge any payment into a superannuation fund under the general antecedent transaction provisions of the *Bankruptcy Act* which are:

1. The "relation back" doctrine;
2. Void settlements — section 120;
3. Fraudulent dispositions — section 121;
4. Voidable preferences — section 122.

Whilst it is beyond the scope of this paper to embark on a detailed examination of each of the above provisions, it should be noted that each is subject to specific time limits and generally the ability of the trustee to call back property becomes more difficult with the passing of time. An exception to this is fraudulent dispositions where, if an actual intention to defraud creditors is proved, there is no time limit applicable.

There are defences to each of the antecedent transaction provisions mentioned above which generally require two kinds of elements to be proved to avoid the

29 Rule 41C(2).
30 Rule 41C(3).

operation of a provision. The first element is related to absence of knowledge of insolvency or an act of bankruptcy. In most cases an institutional superannuation fund will be able to satisfy this element whereas a privately established superannuation fund where the directors of the trustee company are related to the bankrupt may have difficulty doing so.

The second element is that the person receiving the monies must have given valuable consideration for their receipt. Once again the institutional superannuation funds will be more likely to satisfy this element than the private funds. Generally in institutional funds there is a separate agreement between the investor and the trustee setting out matters such as fees and permitted investments. Under such an agreement consideration flows in both directions and such an agreement is likely to satisfy this element of each of the relevant defences. The private funds do not always have a separate agreement governing such matters between the member of the fund and the trustee although such matters are usually set out in the rules of the fund. In this situation, as was the case in the Bond decision, the relationship between the parties is purely one of trustee and beneficiary rather than a contractual relationship[31] and in that situation the trustee will find it more difficult to show valuable consideration was given.

It is arguable that where a trust fund is amended so that a member's beneficial interests are reduced, such an amendment could be void under one of the above provisions, particularly the voidable settlements provision. Such an argument was raised but not, in the end result, pursued in the *Bond* decision.

In general the principles mentioned above have not been explored in decided cases and the extent to which the provisions will be applicable to superannuation deeds and payments into superannuation deeds are yet to be determined.

The "relation back" doctrine was successfully relied upon by the trustee in *Coram* where a member of a fund became entitled to a payment after committing an act of bankruptcy and then purported to direct his trustee (of the deed) to pay his benefit to a new fund. Unfortunately in that decision the defence to the "relation back" does not appear to have been vigorously pursued and was not specifically addressed in the judgment.

VII. Income Contribution and Pensions

Income from a superannuation fund, an annuity, a pension or an approved deposit fund, is all "income" for the purposes of the income contribution provisions in Division 4B Part VI of the *Bankruptcy Act.*[32] This does not mean that the income itself vests in the trustee in bankruptcy. The income does not vest in the trustee in bankruptcy but may form the basis of an assessment by the trustee which gives

31 Court of Appeal decision at page 33 per Gummow J.
32 Section 139L.

rise to a debt.[33] Any assessment can, however, be enforced by a garnishee of further income payable from the same pension in future years.[34]

There appears however to be a gap in the scheme of exemptions in section 116(2) of the Act following its amendment in 1993. Previously annuities and pensions were, in certain circumstances, excluded. Now, as noted above, payments under a pension are not excluded. What seems to have been missed in the amendments however is the pension itself. Any income producing asset such as a pension or an annuity could be "property" which vests in the trustee in bankruptcy. The difficulty does not arise in relation to a bankrupt's employment because the employment itself is not property which can vest in a trustee in bankruptcy. The legislature however seems to have overlooked the possibility that other forms of income production stem from rights which themselves may be property and which can vest in a trustee in bankruptcy. This is of particular concern because of the previous exemption of these classes of property in certain circumstances which would have led to debtors and institutional investors organising their affairs on the basis of those exemptions.

VIII. Conclusion

The *Bond* decision and the 1993 amendments to the *Bankruptcy Act* together have profoundly changed the way in which trustees in bankruptcies and trustees of superannuation funds will view each others rights. The most significant change is the exemption of superannuation funds from bankruptcy where the value of the fund does not exceed the amount of $800,000. This is a very generous concession to debtors, particularly where, subject to the antecedent transactions provisions, monies could be paid into the fund the day before the bankruptcy.

33 *Re Gillies ex parte Official Trustee in Bankruptcy v Gillies* (1993) 42 FCR 571.
34 Section 139ZL.