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No satisfactory answer to fate of KiwiSaver balances in a bankruptcy

The High Court has found that a bankrupt member's interest in a KiwiSaver scheme is available for distribution by the Official Assignee to creditors – but only after the bankrupt qualifies for a withdrawal (which will usually be at age 65) unless early partial release would alleviate the bankrupt's significant financial hardship.

The ruling applies only to the balances existing at the time of, and accumulated during, the bankruptcy – not to any subsequent savings. Who gets the benefit from the earnings, bears the losses and pays the fees on the balance available to the Official Assignee once the bankruptcy has ended is still unclear.

This is an unsatisfactory outcome which, in our view, requires a legislative "fix".

The context

Whether the KiwiSaver accounts of bankrupts are property for the purposes of the Insolvency Act 2006 (Insolvency Act), and therefore pass to the Official Assignee, has long been a bone of contention between the trustees of KiwiSaver schemes and the Official Assignee.

Much hangs on the result as, at May last year, 2,676 KiwiSaver scheme members were in bankruptcy. The KiwiSaver balances for 1,971 of them were cumulatively valued at $7,613,943 and the rest were unknown. These numbers are only likely to increase.

The issue

At issue is the interface between the provisions of the KiwiSaver Act 2006 (KiwiSaver Act) and the Insolvency Act, specifically:

- whether the KiwiSaver interests of bankrupts are "property" for the purpose of the Insolvency Act, and if so
- whether, on bankruptcy, those KiwiSaver interests pass to the Official Assignee, and if so
- whether the Official Assignee can access those KiwiSaver interests under the early withdrawal provisions of the KiwiSaver Act, in particular the "significant financial hardship" provisions.

The case

The case arose when the Official Assignee requested the trustee of a KiwiSaver scheme to release the funds of two bankrupts (Mr T and Mr H) under the significant financial hardship provisions in the KiwiSaver Act. The case is available online[1].

The positions of T and H differed in some important respects:

MR T	MR H
Proven debts of $26,254	Proven debts of $9,583
KiwiSaver balances at the time of bankruptcy totalling $11,860.46	KiwiSaver balances at the time of bankruptcy totalling $10,805.98

The decision

We look at the decision in terms of how the High Court addressed the three key questions set out above.

Are KiwiSaver balances property for the purposes of the Insolvency Act?

In short, yes. KiwiSaver balances were held to be a "valuable thing" belonging to, if not vested in, the bankrupt.

On insolvency, does KiwiSaver property vest in the Official Assignee?

Yes. The Insolvency Act provides that all property belonging to the bankrupt on bankruptcy (section 101) or obtained during bankruptcy (section 102) vests in the Assignee. The Court concluded that these sections overrode section 196 of the KiwiSaver Act, which prevents a KiwiSaver member's interest being passed to any other person unless it is required by another enactment.

Can the Assignee access KiwiSaver interests under the significant financial hardship provisions?

This is where it gets messy.

As a general rule the Official Assignee can only access a bankrupt's KiwiSaver account balances in the same circumstances in which (and to the same extent that) the member could – that is, broadly, after the member has reached 65 or if the trustee is satisfied that the member is suffering or is likely to suffer significant financial hardship. Hardship-based withdrawals must exclude all Crown contribution amounts but can include all member and employer contributions and all investment earnings.

KiwiSaver trustees, however, have discretion to limit the amount which can be withdrawn to what is required to alleviate the hardship in question.

These elements of the significant financial hardship withdrawal provisions raised two questions for the Court to consider:

- is bankruptcy, of itself, significant financial hardship?, and
- can trustees refuse to pay the Official Assignee on the grounds that to do so will not alleviate hardship?

The KiwiSaver Act does not attempt to define significant financial hardship but instead provides a number of illustrative examples. After considering those, the Court concluded that serious financial hardship:

> *"is focused on an inability to meet the "basics" of life including food, shelter and medical care".*

The Official Assignee had argued that bankruptcy is inevitably the result of significant financial hardship and so will inevitably be a qualifying event for early withdrawal purposes.

The Court disagreed, saying applications had to be "properly decided on an individual basis rather than by general declaration". The Court illustrated this with regard to the different circumstances of T and H.

- Mr T had become "instantly better off" after being declared bankrupt because he no longer had to pay off his debts and, because his debts exceeded his KiwiSaver

savings, he would remain bankrupt even after the available money in his KiwiSaver account had been expended. There would therefore be no alleviation of significant financial hardship to him from release of the funds.

- Mr H's KiwiSaver account, by contrast, exceeded his proven debts and, if his available KiwiSaver savings were used to pay his creditors, he could potentially have had his bankruptcy, and all the restrictions that came with it, annulled. The Court seemed to suggest that, in the absence of any other factors, this was enough to satisfy the significant financial hardship withdrawal criteria.

So where does this leave us?

We consider that a legislative fix is needed to deal with the many practical issues that arise from this decision.

It seems to us that the Court has applied two tests of significant financial hardship – whether the bankrupt can meet his or her basic needs and (regardless of whether or not that is the case) whether the KiwiSaver balances are sufficient to deliver the bankrupt from the bankruptcy.

It is difficult to see the authority within the KiwiSaver Act for the second test.

One of the practical outcomes of the decision is that upon bankruptcy the trustee of a member's KiwiSaver scheme is required to establish two separate sub-accounts within the scheme: one holding the Official Assignee's balances and one holding those of the former bankrupt.

While this outcome works in the short term, it does raise a number of practical questions as to how such an arrangement would operate in the longer term:

- If the former bankrupt changed scheme, would the former trustee be required to give notice to the trustee of the new scheme of the need to segregate the balances?
- If notice was not given, would the incoming trustee still be liable for paying away the portion of the member's balances vested in the Official Assignee?
- Would the trustee have to take directions from the Official Assignee as to the investment of the relevant portion of the bankrupt's KiwiSaver balances? What if the new scheme does not provide for split investment allocations?

The declarations made by the Court seem to suggest that following the bankrupt's discharge from bankruptcy, any increases in the value of the bankrupt's KiwiSaver balances which had vested in the Official Assignee would become the property of the bankrupt.

This would seem an odd outcome given that the return was not earned by the member's balances but rather by those held for the Official Assignee. We expect that this may be the result of the specific declarations sought by the Official Assignee and we watch with interest to see whether this point will be clarified.

One of the consequences of this decision is that it is now settled that a bankrupt's KiwiSaver balances are available to meet debts to creditors. However, they are available only when (and to the extent that) the KiwiSaver Scheme Rules allow a withdrawal – so from a creditor's perspective whether funds are available now (under the hardship provision) or at some date far in the future seems to depend on an arbitrary distinction based largely on the value of a member's KiwiSaver balances relative to the level of debt.

From a creditor's perspective, once the balances have vested in the Official Assignee it would seem to serve no compelling policy purpose not to make them available to creditors generally, at the start of the bankruptcy.

The Court itself recognised that issues such as these make the current position unworkable and that a legislative fix is needed.

Footnotes

1. https://forms.justice.govt.nz/search/Documents/pdf/jdo/8e/alfresco/service/api/node/content/workspace/SpacesStore/66c717fe-83a5-4458-b43e-5d9875e6c8ea/66c717fe-83a5-4458-b43e-5d9875e6c8ea.pdf

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