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Death benefit dilemmas: formal and essential validity and effectiveness

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SNAPSHOT

- In recent months, a host of decisions by the Australian Financial Complaints Authority regarding payment of a deceased member's death benefit offer insight into the different methods by which payment of the death benefit can be decided, and AFCA's role in that process.
- This article, the first in a two-part series, discusses the requirements for a member's nomination to be formally and essentially valid, as well as effective.
- Whenever a solicitor advises on payment of a member's death benefit—whether to ensure formal validity as part of a member's estate planning or to advise a person making a claim after the member's death—it is critical to check the relevant provisions of the superannuation fund's trust deed.

How do trustees and the Australian Financial Complaints Authority ('**AFCA**') determine the validity and effectiveness of superannuation death benefit nominations? Recent AFCA decisions outline the requirements for formal and essential validity, explain how effectiveness is assessed and explore what happens when no valid nomination exists—including how trustees identify eligible beneficiaries and exercise their discretion in distributing the benefit.

Is there a nomination which is formally valid and effective? (Check the trust deed)

The first action required of the trustee of a superannuation fund when it learns of the death of a member of the fund is to ascertain whether the member made a death benefit nomination which is valid and effective. To be valid, there must be formal validity and essential validity. To be effective, the nomination must achieve what the member wants to achieve by nominating a person who is able to receive the death benefit (i.e. an '**eligible beneficiary**') and be binding on the trustee.

Both the requirements for formal validity and effectiveness are ascertained by reference, in the first instance, to the fund's trust deed (or similar instrument). The trust deed may, and often does, direct attention to the supervision legislation for funds, the *Superannuation Industry (Supervision) Act 1993* (Cth) ('***SIS Act***'), or the supporting regulations, the *Superannuation Industry (Supervision) Regulations 1994* (Cth).

There are sometimes inconsistencies between the terms of the trust deed and the legislation or regulations. A common example is the definition of 'dependant'. For instance, the definition of dependant in the trust deed in *Case 12-00-1010238 (concerning HTFS Nominees Pty Ltd)* did not include a person in an interdependency relationship whereas this category is included in the legislative definition of dependant in section 10(1) of the *SIS Act*.

Sometimes the trust deed may have a wider definition of dependant than appears in the legislation. Sometimes it will be narrower. Oftentimes there is a different approach. For instance, the legislation generally contains contextual and inclusive definitions (such as 'unless the context provides otherwise, [expression] includes...') whereas many trust deeds provide textual and exclusive definitions (such as 'in this deed, [expression] means...').

Unless the trust deed provides otherwise, where there is an inconsistency, the trust deed prevails, even if this results in the fund not complying with the legislation (*Dawson v Dawson* [2019] NSWSC 826). An approach which is sometimes adopted by the trust deed to avoid the dilemma of a trustee acting in breach of trust or not complying with legislative obligations is for the trust deed to make itself subservient to the legislation to the extent of any inconsistency (*Phillips v Newcastle Permanent Custodians Pty Ltd* [1998] NSWSC 519).

Take home message 1: Always read the trust deed to ascertain the method that must be used to make a formally valid and effective nomination. Always read the trust deed to determine the eligible beneficiaries; it may be different to the customary collection.

Is there a nomination which is essentially valid?

A nomination will not be valid if it is made by the member at a time he or she lacks mental capacity or has been unduly influenced or affected by unconscionable conduct. At times, the trustee—and, on review, AFCA—must decide these issues. This occurred in *Case 12-24-113046 (concerning HFTS Nominees Pty Ltd)*. There was an allegation the member's non-lapsing nomination was invalid because of a lack of essential validity in various ways.

First, there was an allegation of a lack of 'testamentary capacity' which AFCA (correctly, because the nomination is not a will) treated as an allegation of a lack of mental capacity. The following facts were relied on:

- the member was diagnosed with stage four cancer a month before making the non-lapsing nomination;
- he died within two months;
- between diagnosis and death, the member became increasingly delusional, paranoid and emotionally unstable;
- the member lived with an alcohol use disorder;
- the member increased his drinking after his cancer diagnosis;
- the member was taking opioids and sedatives; and
- the member's signature was shaky and not easily recognisable.

Relying on the evidence of the solicitor who prepared the member's will, nomination and codicil—which the member executed within a period of six days—AFCA concluded the member knew what he was doing. AFCA noted the solicitor was directly involved in the member's decision making and an independent witness.

There were also allegations of undue influence, duress and unconscionable conduct. AFCA concluded there was no undue influence but did not set out the law or make any finding of fact supporting that conclusion. AFCA made no determination concerning the allegations of duress or unconscionable conduct. Whilst it did not state that those decisions were beyond its expertise, it did express a reluctance to be involved in making those decisions:

> 'The panel noted that questions of capacity are best considered in other forums, for example by a specialist tribunal, as AFCA's role is to determine whether a trustee decision is fair and reasonable, not to determine legal matters. A finding of lack of capacity cannot be made on inference alone. That said, AFCA is able to make findings about legal matters as part of determining whether a decision is fair and reasonable' (at [2.2]).

***Take home message 2*:** There are sound reasons for concluding that allegations of a lack of essential validity are better made in the Supreme Court, as occurred in *van Camp v Bellahealth Pty Ltd* [2024] NSWSC 7 (albeit those proceedings involved a self-managed superannuation fund where AFCA has no authority in any event).

Effectiveness is determined at the date of the member's death

Formal validity and essential validity must exist at the time the nomination is made. The position is different when deciding whether a nomination is effective. This was an issue in *Case 12-00-1036445 (concerning Team Super Pty Ltd)*. The member made a nomination on 31 October 2019 in favour of his sister on the basis of an interdependent relationship. The nomination purported to be binding. A person with whom the member had an 'interdependency relationship' was an eligible beneficiary. The effectiveness of the nomination therefore depended on whether the member satisfied the requirements of an interdependency relationship with his sister.

At the time the nomination was made, the sister did not satisfy those requirements. However, in September 2022, the member started to live with and be cared for by the sister. That continued until the member's death in October 2022.

After the member's death, the member's minor son claimed the member's death benefit of $188,660. The success of that application depended on whether the nomination was valid and effective. The son argued it was not effective as the sister was not in an interdependent relationship with the member at the date of the nomination or at his death.

AFCA decided the time for determining whether someone is a dependant is at the time when the death benefit becomes payable. It was payable when the member died. At that date, the sister satisfied the requirements for an interdependency relationship: namely, they had a close personal relationship, lived together, one or each provided financial support and one or each provided domestic support and personal care. As a result, the nomination was held to be effective and bound the trustee to pay the death benefit to the member's sister. The son's claim failed.

If there is not a valid and effective nomination, who gets the death benefit? (Check the trust deed)

If there is a valid and effective nomination, the trustee's task is simple: it will pay the death benefit in accordance with the nomination. If there is not a valid and effective nomination, the trustee must pay the death benefit in the manner specified in the trust deed. Usually, this means paying the death benefit to the member's legal personal representative ('**LPR**') and/or the member's dependants. However, the trust deed may provide differently.

An example is the trust deed considered in *Case 12-00-1100166 (concerning OnePath Custodians Pty Ltd)*. The member made a non-lapsing nomination in favour of his de facto spouse in 2021. They separated a year later and that remained the position at the member's death in 2022. The trustee and AFCA considered the nominated person was not the member's spouse nor a dependant at the member's death, so the non-lapsing nomination was ineffective.

The trust deed provided that, if there was no nomination, the trustee must pay the death benefit, if the member's estate is solvent, to their LPR. If there was no LPR, the trustee must pay the benefit to the member's spouse. If there was no spouse, the trustee must pay the benefit to one or more of the member's dependants in the proportions the trustee determines. There was no LPR and no spouse. The only dependant was the member's child. In circumstances where there was no other option, AFCA decided the trustee's decision that the death benefit be paid to the child was fair and reasonable.

Another example is the trust deed in *Case 12-00-1051967 (concerning Mercer Superannuation (Australia) Ltd)*. The trust deed required the trustee to pay the death benefit to the member's LPR if there was no nomination. It was only if there was no LPR in existence within a reasonable time of the member's death that the trustee could pay the death benefit to member's dependants.

The trustee must make its decision in accordance with the trust deed, even if all eligible beneficiaries agree otherwise. That occurred in *Case 12-00-1064932 (concerning CareSuper Pty Ltd)*. The member's spouse and LPR agreed that only $25,744.51 of the death benefit (of $58,582.23) be paid to the spouse. The trustee decided to pay it *all* to the spouse.

Take home message 3: To ascertain the eligible beneficiaries, it is vital to read the trust deed.

If there is not a valid and effective nomination and more than one eligible beneficiary?

Where there is not a valid and effective nomination, the trust deed allows the member's death benefit to be paid to more than one person, and more than one person is an eligible beneficiary, the trustee has a discretion as to which of the eligible beneficiaries should receive the death benefit. If the trustee decides that more than one eligible beneficiary should receive part of the death benefit, the trustee has a discretion as to how much each eligible beneficiary should receive.

In both respects, the trustee's discretion is not 'at large'. It must be exercised having regard to a range of factors, which can be summarised as:

- *The member's wishes*: this is probably the primary factor which is understandable because the death benefit is the member's money. Wishes may be expressed in a non-valid or non-effective nomination of the member, the member's will (including an informal will) and in other less formal ways, such as the recollections of others (as occurred in *Case 12-00-1051967 (concerning Mercer Superannuation (Australia) Ltd)*).
- *The nature, degree and duration of the eligible beneficiary's reliance (or dependence) on the member whilst the member was alive*: this encapsulates the consideration of past events, as explained in *Aafjes v Kearney* [1976] HCA 5 and *Noel v Cook* [2004] FCA 479. This factor is important because it is difficult to predict the future (the next factor) without knowing relevant aspects of the member's past.
- *The likely nature, degree and duration of the eligible beneficiary's reliance (or dependence) on the member if the member was still living*: the eligible beneficiary's age may be a relevant factor in this context.
- *The solvency (or otherwise) of the member's estate*: this is relevant as AFCA considers the member's death benefit should not be used to meet expenses accrued by the member during life, as explained in *Case 12-00-1089124 (concerning Mercer Superannuation (Australia) Ltd)* as follows:

'a discretionary decision to pay the deceased member's LPR would generally only be fair and reasonable if there were no dependants. This is because a distribution to the deceased member's LPR could mean that the death benefit is used to pay creditors. This is relevant to this complaint because the deceased member had a large debt owing to the Australian Taxation Office at the date of his death, and the estate has liabilities for funeral costs. It is not a purpose of a superannuation death benefit to meet debts of a deceased member's estate' (at [2.3]).