Maryland Law Review

Volume 22 | Issue 1 Article 10

Exemption Of Life Insurance Cash Surrender Values From Bankruptcy Proceedings In Maryland - In re Posin

Melvin D. Hill

Exemption Of Life Insurance Cash Surrender Values From Bankruptcy Proceedings In Maryland

In re Posin[1]

In bankruptcy proceedings, the Referee refused to allow bankrupt to exempt from the schedule of his assets the cash surrender value of several life insurance policies on his life, payable to his wife as beneficiary.[2] The Referee, agreeing with the contention of the trustee in bankruptcy, took the position that Article III, Section 44, of the Maryland Constitution, which puts a $500 limitation on the amount of property exempt from execution,[3] must be read into Article 48A, Section 166 of the Maryland Code, which purports to exempt the cash surrender value of all life insurance policies payable to the wife, children or dependent relatives of the insured from all claims of creditors.[4] Such a reading would subject the cash surrender value of the policies to the $500 Constitutional ceiling on debtor's exemptions. The United States District Court for Maryland refused to follow this reasoning and allowed the full cash surrender value to be exempt from the bankrupt's schedule of assets. District Judge Watkins reasoned that a life insurance policy, being a chose in action, is not subject to

[1] 183 F. Supp. 380 (D.C. Md. 1960) aff'd 284 F. 2d 300 (4th Cir. 1960).

[2] Bankrupt's schedule showed liabilities of $734,068.28 and assets of $14,199.42. There were six life insurance policies plus a National Service Life Insurance policy, the full cash surrender value of the NSLI policy being allowed. The schedule of exemptions was as follows:

Wearing apparel	$ 25.00
Watch	4.00
Policy No. 2315410.....	392.35
Policy No. 2315411.....	78.65
	$500.00

The referee refused to allow as exempt the remaining cash surrender value of policy No. 2315411 and the cash surrender values of 4 other policies.

[3] MD. CONST. Art. III, § 44: "Laws shall be passed, to protect from execution, a reasonable amount of the property of the debtor, not exceeding in value, the sum of five hundred dollars."

[4] 5 MD. CODE (1957) Art. 48A, § 166:

"The proceeds, including death benefits, cash surrender and loan values . . . of any policy of life insurance or any annuity contract upon the life of any person heretofore or hereafter made for the benefit of or assigned to the wife or children or dependent relative of such person, shall be exempt from all claims of the creditors of such person arising out of or based upon any obligation created after June 1, 1945, whether or not the right to change the named beneficiary is reserved or permitted to such person. * * *

"A change of beneficiary or assignment or other transfer shall be valid except in cases of transfer with actual intent to hinder, delay or defraud creditors."

execution, the term used in the constitutional provision, and is, therefore, not subject to that limitation.

The trustee and Referee had relied primarily on *In re Jones*,[5] where the court held in a supplemental opinion[6] that the cash surrender value of a life insurance policy is subject to Article III, Section 44. In the original decision of that case, the District Judge had said that the cash surrender value was not subject to creditors' claims in that, though the insured had the right to change the beneficiary, he had not done so and probably would not do so, in the light of the general practice of holders of policies with such a right. Therefore, there was no cash surrender value payable to the bankrupt, his estate or personal representatives. Before any order had been issued, the Supreme Court held in *Cohen v. Samuels*,[7] that an insurance policy on a debtor's life is an asset of the insured in bankruptcy, although the beneficiary is someone other than the insured, if the insured has reserved the right to change the beneficiary. The Court's decision was based on an interpretation of Section 70A of the Bankruptcy Act.[8] Sub-division 3 of this Section states that among the property to which the trustee gets title are powers which the bankrupt might have exercised for his own benefit, but not those powers which he might have exercised for some other person. The Court reasoned that since the bankrupt could have made these policies in question payable to himself, they fall within sub-division 3. In view of the *Cohen* decision, the District Judge filed a supplemental opinion in the *Jones* case holding the policy to be an asset of the debtor and thereby only exempt from debtor's schedule of assets in bankruptcy if included in the $500 constitutional limitation.[9]

In tacitly overruling the *Jones* case, District Judge Watkins, in the instant case, based his decision on the difference between attachment on judgment and an execution, the term used in the constitutional provision. In *Himmel v. Eichengreen*,[10] the Maryland Court of Appeals

[5] 249 F. 487 (D.C. Md. 1917).

[6] *Id.*, 490.

[7] 245 U.S. 50 (1917).

[8] 66 STAT. 429 (1952), 11 U.S.C.A. § 110 (1953).

[9] 7 MD. CODE (1957) Art. 83, § 8 exempts all money payable in nature of insurance from execution or seizure in satisfaction of debt or claim upon any judgment in any civil proceedings (with two exceptions not pertinent here), but MD. CONST. Art. III, § 44 has the effect of limiting this exemption to $500. This applies to benefits received by the insured, and includes benefit payments for sickness and accident insurance.

[10] 107 Md. 610, 69 A. 511 (1908).

recognized this distinction in holding that an attachment is not such an execution as was intended by the constitutional provision. Professor Arnold, in an earlier issue of the MARYLAND LAW REVIEW,[11] analyzed the problem of attachment and execution, and anticipated a decision such as the one in the instant case.

Article III, Section 44 uses the word "execution." A chose in action has been held not subject to execution in Maryland,[12] and an insurance policy is a chose in action.[13] It then follows that an insurance policy cannot be executed upon.

The Supreme Court has held that policies exempt from levy by creditors under state laws are also exempt under the Federal Bankruptcy Act.[14] Section 6 of the Act gives effect to exemptions provided by the law of the state in force at the time of the filing of the petition, if the bankrupt has had a domicile within the state for at least six months immediately preceding the petition.[15] Section 70 provides for insurance policies of the bankrupt to pass to the trustee, if no state exemption statute is found in the bankrupt's state of domicile, but allows the bankrupt to keep the policy if he pays the trustee the ascertained cash surrender value of the policy.[16] Consequently, whether the trustee will be allowed to reach the cash surrender value of bankrupt's life insurance will depend largely on state exemption statutes.

Smith v. Metropolitan Life Ins. Co.[17] was a bankruptcy proceeding arising under New Jersey law and involved a statute,[18] although not speaking in terms of execution or attachment,[19] similar in content to Article 48A, Section 166. The cash surrender value of the policy was held exempt and did not pass to the trustee as part of the bankrupt's schedule of assets.

A New York statute allows exemption of cash surrender values of policies payable to a third person beneficiary from the claims of trustees in bankruptcy, even if

[11] Arnold, *Life Insurance as an Asset Available to Creditors in Maryland*, 6 Md. L. Rev. 275 (1942).

[12] Harford Bank v. Banking and Tr. Co., 165 Md. 454, 169 A. 315 (1933). A widow's right of dower, being a chose in action, was held not to be subject to execution.

[13] Ritter v. Smith, 70 Md. 261, 16 A. 890 (1889).

[14] Holden v. Stratton, 198 U.S. 202 (1905).

[15] 52 STAT. 847 (1938), 11 U.S.C.A. § 24 (1927).

[16] 52 STAT. 879 (1938), 11 U.S.C.A. § 110 (1953).

[17] 43 F. 2d 74 (3d Cir. 1930).

[18] 2 N.J. COMP. ST. (1910) p. 2850 (INSURANCE LAW OF N.J. § 38), now 17 N.J.S.A. (1937) § 17:34-28.

[19] *Ibid.* "[T]he lawful beneficiary . . . shall be entitled to its proceeds, against the creditors. . . . "

the insured has the right to change the beneficiary.[20] Under the predecessor of this law,[21] in *In re Solomons*,[22] it was held that although the cash surrender value of a policy is exempt from the claims of the trustee, the claim must have arisen after the enactment of the statute. In light of this, the bankrupt was not allowed the exemption, the particular claim having arisen prior to enactment.

The Illinois statute exempting proceeds of a life insurance policy goes further than the Maryland statute in that it states life insurance proceeds "shall be exempt from execution, attachment, garnishment, or other process. . . ."[23] In *In re Schiar*,[24] a case decided under this statute, the court held that although such proceeds are exempt, the exemption would not be allowed, where the bankrupt's children-beneficiaries were adults not dependent on the bankrupt for support since the statute speaks of policies payable "to a wife or husband of the insured, or to a child, parent, or other person *dependent* upon the insured. . . ."[25]

Where adult non-dependent children are beneficiaries of the bankrupt's life insurance, one presented with the Maryland exemption statute would have to look beyond the bare words of the statute and construe the statute in light of its apparent underlying purpose, in order to hold similarly to the *Schiar* case. Article 48A, Section 166 exempts life insurance "for the benefit of or assigned to the wife or children or dependent relative. . . ."[26] To exclude non-dependent adult children, the word "other" would have to be read into the statute before the word "dependent." Such a reading might be justified since the underlying purpose of a statute exempting life insurance seems to be a desire to protect those actually dependent for their welfare on the bankrupt.[27] On the other hand, the Court of Appeals for the Fourth Circuit has said that "the better and almost universal rule is that such statutes should receive a liberal construction in favor of the debtor. . . ."[28] A liberal construction might be held to include those non-dependent children.

---

[20] 27 McKINNEY'S CONSOL. LAWS OF N.Y., Art. 7, § 166.

[21] INSURANCE LAW OF N.Y., ch. 33, § 55a (1927).

[22] 2 F. Supp. 572 (S.D. N.Y. 1932).

[23] 73 ILL. REV. STAT., ch. 73, § 850, p. 333 (1937).

[24] 179 F. Supp. 157 (N.D. Ill. 1959).

[25] *Supra*, n. 23. Emphasis added.

[26] *Supra*, n. 4.

[27] Lake v. New York Life Insurance Company, 218 F. 2d 394, 399 (4th Cir. 1955) (dicta).

[28] Hickman v. Hanover, 33 F. 2d 873, 874 (4th Cir. 1929).

The problem of a possible fraud on creditors by the use of exempt life insurance proceeds is of concern to some authorities.

> "Consequently, a debtor wishing to shield money from his creditors may take out insurance in favor of his wife or some other qualified beneficiary, knowing that at any time he can make himself the beneficiary and realize the cash value of the policy, either by surrender or loan. It is thus practically a cash asset, and the exemption is manifestly adopted to abuse, particularly since . . . no monetary limit is set upon the exemption. . . ."[29]

Maryland appears to have erected safeguards against such abuse by the provision in Article 48A, Section 166, which makes changes of beneficiary or assignment or any transfer valid unless the transfer is with the intent to hinder, delay or defraud creditors. No cases in Maryland have tested the effectiveness of this safeguard.

In any case, it now appears, in light of the well-reasoned opinion by District Judge Watkins, that in Maryland, proceeds of life insurance on the life of the bankrupt payable to his wife, children or dependent relatives will be excluded from property passing to the trustee in bankruptcy for distribution to creditors, if no elements of fraud are present. Therefore, a legitimate concern of the bankrupt for the welfare of his dependents will be recognized by the courts.

MELVIN D. HILL

---

[29] MCLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY (1956) § 161, p. 160.