

## Memorandum 74-23

Subject: Study 39.120 --Execution (Exemptions--Health, Disability, and Life Insurance; Unemployment and Workmen's Compensation)

This memorandum discusses the exemption of health, disability, and life insurance, and unemployment and workmen's compensation benefits. In Chapter 5 of the draft statute (attached to Memorandum 74-17), the provisions concerning the various types of insurance (see §§ 705.420-705.530) essentially restate existing law. However, at the last meeting, the Commission indicated that it wanted to undertake a thorough revision of the law concerning enforcement of judgments; from this the staff assumes the Commission will also want to examine the basic issues involved in the various exemptions.

Disability, Health, Workmen's Compensation, Unemployment Benefits

Under current law and in the draft statute, the exemptions of disability, health, workmen's compensation, and unemployment benefits are provided by several different sections as follows:

(1) Disability or health insurance benefits are exempt in an amount represented by, at most, a \$500 annual premium (§ 690.11; draft § 705.420).

(2) Disability and other benefits received from a governmental entity are entirely exempt (§ 690.18; draft § 705.450).

(3) Disability benefits payable under a life insurance policy, perhaps, are exempt in an amount represented by a \$500 annual premium plus another such amount in favor of the insured's spouse and minor children (§ 690.9; draft § 705.430). Group life benefits are entirely exempt (§ 690.10; draft § 705.440).

(4) Benefits from a fraternal benefit society are entirely exempt (§ 690.14; draft § 705.520).

(5) Workmen's compensation benefits are entirely exempt (§ 690.15; draft § 705.480).

(6) Unemployment and disability benefits deriving from the Unemployment Insurance Code are entirely exempt (§§ 690.16 and 690.175; draft §§ 705.490 and 705.500).

Health, disability, workmen's compensation, and unemployment benefits should be entirely exempt in recognition of the policy that generally such benefits are designed to compensate the recipient for a specific physical loss suffered or for minimal living expenses at a time when through misfortune the recipient is unable to work. The current \$500 annual premium limitation on health and disability insurance serves no identifiable policy and should be eliminated. Section 4-503(c)(7)-(8) of the proposed bankruptcy act (see Exhibit II) completely exempts "disability benefits" and "proceeds, benefits, or other rights to which the debtor is entitled as a result of any personal injury or unemployment."

In addition, the exemption should be drafted to apply to such benefits regardless of their source; hence, for example, separate provisions for exemptions of disability benefits from fraternal benefit societies, life insurance, disability insurance, unemployment compensation, or workmen's compensation are unnecessary.

#### Life Insurance

In marked contrast to health and disability insurance, life insurance is in large measure an investment, and benefits payable are not directly related to any specific loss. Hence, the policy which indicates that health and disability benefits should be completely exempt does not apply to life insurance benefits. Various reasons for exempting life insurance benefits have been offered:

(1) To allow a person to provide for the reasonable support of his dependents after his death.

(2) To enable the head of the family to provide a living for his family after death above and beyond his financial conditions before death.

(3) To benefit the beneficiary regardless of any creditor of the insured.

(4) To encourage the rehabilitation of debtors.

(5) To shift the burden of social welfare from the community to creditors.

The staff thinks that the primary policy should be the first--the support of the insured debtor's dependents after his death. It should be noted, however, that the general movement of exemption statutes in the United States has been away from this restrictive policy. California law recognizes both this policy (subject to the \$500 annual premium limitation) and the broader policy of allowing any beneficiary to benefit as long as the annual premiums do not exceed \$500. The \$500 annual premium limitation, dating from 1872, does not make much sense since the benefits resulting from such a policy can vary greatly depending on the type of policy, the maturity date of the policy, and the age of the insured. In addition, in California the exemption applies to the funds in the hands of the beneficiary too, even where the beneficiary is a business creditor of the insured debtor. (See discussion of Jackson v. Fisher, 56 Cal.2d 196, 363 P.2d 479, 14 Cal. Rptr. 439 (1961), from 14 Stan L. Rev. 599, attached as Exhibit I.) This seems overly generous.

The following factors may be manipulated to achieve a particular policy:

(1) Type of policy. The exemption may be made to depend on whether the policy is straight life, endowment, annuity, or some other form.

(2) Type of benefit. The type of benefit may depend on the type of policy but, within a given class of policy, there may be different benefits and

privileges, such as the right to assign or change beneficiaries, to surrender the policy for its cash value, to borrow on the cash value, to choose whether the face value is paid off in a lump sum only on the death of the insured or may be taken while he is alive in installments or as a lump sum.

(3) Amount of benefit. The exemption may have no value limitation or limits may be placed on the amount of the benefit or on the amount of the premium paid. Different exemption amounts may be allowed on distinct types of benefits such as cash surrender value, endowment option, or face value at death of insured. The amount of the exemption may depend on the number of dependent beneficiaries. Since value limitations eventually become obsolete due to inflation, the amount of the exempt benefit may be made to depend on the amount necessary for support as in the proposed bankruptcy act (Exhibit II).

(4) Type of insured. The exemption may depend on the age, solvency, family status, and the like of the insured.

(5) Type of beneficiary. The exemption may depend on whether the beneficiary is an individual, a creditor of insured, a spouse, minor child, dependent, the debtor himself, or the insured's estate.

(6) Type of source of premiums. The exemption may depend upon whether the debtor's life is insured by someone other than himself, such as his spouse or creditor.

(7) Type of insurer. The exemption may depend upon the type of insurer, such as private or governmental, mutual association or corporation, and the like. Presently, California law provides an exemption for life insurance generally in Section 690.9 (draft § 705.430), for group life in Section 690.10 (draft § 705.440), for public employee death benefits in Section 690.18 (draft § 705.450), and perhaps for some life coverage from fraternal benefit societies in Section 690.14 (draft § 705.520).

(8) Extent of exemption. The exemption may protect only the debtor or may include his dependent beneficiaries or any other beneficiary. The exemption may be made ineffective when the policy is assigned.

(9) Insolvency. Some states provide that the exemption is not good if the insurance is purchased by the debtor while he is insolvent or if purchased with intent to defraud creditors.

A collection of exemption statutes illustrating many of the above factors is attached. The proposed bankruptcy act provisions (Exhibit II) illustrate the limitation to dependent beneficiaries where benefits are necessary for support. The Maryland statute (Exhibit III) contains a provision allowing a creditor to which a policy has been pledged to collect the amount of the debt. The New York statute (Exhibit IV) is an example of a highly detailed provision. The Ohio statute (Exhibit V) applies to life, endowment, and annuities. The Pennsylvania provisions (Exhibit VI) allow the insured to restrict the access of the beneficiary's creditor to policy benefits; annuity payments are restricted to \$100 per month. The South Dakota provision (Exhibit VII) contains a \$10,000 proceeds limitation.

The following is a proposed staff draft of an exemption for life insurance benefits which seeks primarily to protect the interests of the debtor's dependents.

§ \_\_\_\_\_. (a) The net amount of all death benefits growing out of any life insurance, endowment insurance, disability insurance, or annuity in favor of the surviving spouse or dependents of the insured or annuitant debtor is exempt [in an amount not exceeding twenty thousand dollars (\$20,000) for each such beneficiary].

(b) The net amount payable during the life of the insured, including cash surrender value, loan value, and accumulated dividends, growing out of any life insurance in favor of the spouse or dependents of the insured are exempt [in an amount not exceeding ten thousand dollars (\$10,000) for each such beneficiary][whether or not the right to change the named beneficiary is reserved or permitted].

Should the exemption be limited in amount as suggested in the brackets in both subdivisions (a) and (b)?

Should the exemption apply as well where benefits are payable to the estate, assuming there are dependents?

Non-death benefits growing out of endowment policies or annuities should be treated with retirement and pension funds, and so are not treated here.

A distinct but related problem concerns the manner of collection of the nonexempt cash value. Under current law and under the attachment recommendation (§ 488.370), the insurer is garnished. The staff would like to know the Commission's views on a provision such as that found in the proposed bankruptcy act (Exhibit II, § 4-503(d)) where insurance with a cash value in excess of \$1,500 is exempt if the debtor pays the amount of the excess to the trustee in bankruptcy within 30 days.

Respectfully submitted,

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EXHIBIT I

[14 Stan. L. Rev. 599 (1962)]

## California Creditor Beneficiary's Insurance Proceeds Are Exempt From Execution

CREDITORS' RIGHTS—INSURANCE—EXEMPTION FROM EXECUTION  
—CALIFORNIA CODE OF CIVIL PROCEDURE SECTION 690.19.—Insured bought defendant's business on an installment contract. Pursuant to the contract he took out a life insurance policy naming defendant as beneficiary to the extent of his remaining interest, with the balance payable to the insured's wife. Insured died and the insurer paid defendant the amount owing on the contract, 119,211.63 dollars. Defendant's creditors levied execution on the insurance proceeds, 113,200 dollars of which defendant claimed was exempt by sections 690<sup>1</sup> and 690.19<sup>2</sup> of the California Code of Civil Procedure.<sup>3</sup> The trial court held that these life insurance exemptions were not available to one who extended credit to become a bene-

1. "The property mentioned in Sections 690.1 to 690.25, inclusive, this code, is exempt from execution or attachment, except as therein otherwise specially provided, when claim for exemption is made to the same by the judgment debtor or defendant as herein-after in Section 690.26 provided."

2. "All moneys, benefits, privileges, or immunities, accruing or in any manner growing out of any life insurance, if the annual premiums paid do not exceed five hundred dollars (\$500), or if they exceed that sum a like exemption shall exist which shall bear the same proportion to the moneys, benefits, privileges, and immunities so accruing or growing out of such insurance that said five hundred dollars (\$500) bears to the whole annual premium paid."

For the second paragraph, not invoked in the *Jackson* case, see note 7 *infra*.

3. Total proceeds of the policy were \$200,000; total annual premium was \$883. Defendant claimed the total exemption of \$200,000 multiplied by the ratio 500/883 (or 56.6%), i.e., \$113,200.

fiary (hereinafter "creditor beneficiary"). On appeal to the California Supreme Court, *held*, Reversed. The exemption from execution provided by the first paragraph of section 690.19 is available to a creditor beneficiary. Where the total annual premium exceeds 500 dollars the amount of exemption is the creditor beneficiary's proceeds multiplied by the ratio of 500 dollars to the total annual premium.<sup>4</sup> *Jackson v. Fisher*, 56 Adv. Cal. 186, 363 P.2d 479, 14 Cal. Rep. 439 (1967).

Initially the California exemption of insurance proceeds was limited to benefits accruing from a maximum of 500 dollars annual premium and expressly applied only to insurance on the life of the judgment debtor.<sup>5</sup> A 1901 amendment<sup>6</sup> retained the 500-dollar limitation but broadened the language to cover benefits accruing from any life insurance. After 1947 a second paragraph provided a further exemption for benefits inuring to the insured's spouse or minor children and growing out of an additional 500-dollar premium.<sup>7</sup>

Construing the 1901 version of the section in *Holmes v. Marshall*,<sup>8</sup> the California Supreme Court rejected the contention that section 690.19 could exclude attachment only for debts of the insured and held that proceeds going to a widow were exempt from attachment by her creditors. This result followed from the court's

4. The defendant was accordingly allowed an exemption of \$67,473.84, i.e., his proceeds (\$119,211.63) multiplied by 500/883.

It is not clear whether the basis for exemption is the total annual premium on only the policies of which the judgment debtor was a beneficiary, or on all policies on the life of the insured. There were two policies on the life of the decedent in the *Jackson* case, but since only the one naming defendant as beneficiary was presented to the trial court, only that one was considered by the supreme court. See Brief of Amicus Curiae in Support of Defendants, p. 7. The language of the opinion, however, suggests that all policies, if presented, would be considered in determining the exemption.

5. Cal. Stat. 1868, ch. 406, § 1, at 500: "No money, benefit, right, privilege or immunity accruing or in any manner whatever growing out of any life insurance on the life of the debtor . . . shall be subject to levy under attachment or execution . . . provided, however, this exemption shall not extend beyond such moneys, benefits, rights, privileges and immunities as have been or might have been secured by the payment of an annual premium not exceeding five hundred dollars." (Emphasis added.)

It should be noted that the same kind of broad language that the *Jackson* court found compelling was included in the original statute from which the present version was derived, although a beneficiary's proceeds were clearly not exempt at that time.

6. Cal. Stat. 1901, ch. 28, § 1, at 23. This amendment made the statute virtually identical with the first paragraph of the present § 690.19, note 2 *supra*.

7. "In addition to the foregoing, all moneys, benefits or privileges belonging to or inuring to the benefit of the insured's spouse or minor children growing out of life insurance purchased with annual premiums not exceeding five hundred dollars (\$500), or if such annual premiums exceed that sum, a like exemption shall exist in favor of such persons which shall bear the same proportion to the moneys, benefits or privileges growing out of such insurance that five hundred dollars (\$500) bears to the whole annual premiums paid." CAL. CODE CIV. PROC. § 690.19.

8. 145 Cal. 777, 79 Pac. 534 (1905).



recognition that the policy of the statute is to protect debtors and their families from poverty. And in *In the Matter of Estate of Starr*,<sup>9</sup> a later case where decedent left no wife or minor children, the court limited the scope of the 1901 version of section 690.19 by holding that it did not exempt insurance proceeds going to the estate from debts of the estate. In *Bowman v. Wilkinson*,<sup>10</sup> the only case construing the section since the 1947 amendment, the court followed *Holmes* by exempting a widow's proceeds from her creditors under the first paragraph of section 690.19. The two questions in the *Jackson* case were whether life insurance proceeds paid to a creditor beneficiary are exempt from execution, and if so, to what extent. These questions apparently had not been decided by any appellate court in the United States.<sup>11</sup>

The *Jackson* court relied on the "plain meaning" of the statute, reasoning that since sections 690 and 690.19 do not restrict the exemption to family beneficiaries they must apply to all beneficiaries. The court further stated that the exemption could not be confined to family beneficiaries because the first paragraph—the only one in issue here—must confer an exemption on beneficiaries other than the widow and minor children who are mentioned explicitly in the second paragraph. But the meaning of the first paragraph is not so clear as the court indicated. Its history suggests that perhaps it was not designed to apply directly to beneficiaries, but

9. 183 Cal. 121, 190 Pac. 625 (1920). A creditor obtained a judgment against the insured's administratrix. The superior court decree of distribution ordered satisfaction of the judgment out of insurance proceeds left to the estate, and the California Supreme Court affirmed. The opinion is not clear whether the creditor's judgment was obtained in probate court and, therefore, in a sense self-executing because it constituted a partial decree of distribution; or whether it was obtained elsewhere and presented to the probate court for execution. However, the court decided the case as though plaintiff were seeking execution within the meaning of §§ 690 and 690.19 (then § 690(18)). The court's reasoning indicated that in such a case § 690.19 had force only by virtue of Code of Civil Procedure § 1465 (now Probate Code § 660), which declared that exempt property of a decedent may be set apart for the use of a surviving spouse or minor children. Absent such a survivor, the life insurance proceeds were subject to the claims of decedent's creditors.

10. 153 Cal. App. 2d 391, 314 P.2d 574 (2d Dist. 1957).

11. The language of the exemption statutes of most of the states would seem to preclude the possibility of the result reached in the *Jackson* case. See, e.g., IDAHO CODE ANN. § 11-205 (1948); N.Y. INS. LAW § 166; S.D. CODE § 31.1509 (1939). The New York statute, contrary to § 690.19, quite explicitly indicates the limit to which the purpose of the statute requires defeat of creditors' claims: it allows all beneficiaries to take proceeds exempt from the insured's creditors, but only a wife can take exempt from her own creditors.

The language of the following statutes is broad enough to allow a creditor beneficiary to claim exemption of insurance proceeds, but no reported case was found in which such a claim was attempted: ARK. STAT. § 30-208 (1947); COLO. REV. STAT. ANN. § 77-13-2(m) (Supp. 1960); KAN. GEN. STAT. ANN. § 40-414 (1949); LA. REV. STAT. § 22:647 (1950); WASH. REV. CODE ANN. § 48.18.410 (1961).

For a comprehensive analysis of life insurance exemption statutes see Riesenfeld, *Life Insurance and Creditors' Remedies in the United States*, 4 U.C.L.A.L. REV. 583 (1957).

only to prohibit the insured's creditors from attaching his interests in the policy while he lived.<sup>12</sup> *Holmes* made it clear that a family beneficiary's proceeds could also be exempt, but *Starr* indicated that not all life insurance proceeds were protected from creditors' claims. Perhaps the legislature in 1947 simply accepted the *Holmes* interpretation as defining the scope of the first paragraph of section 690.19 and limited the insured's additional exemption of his incidents of ownership under the second paragraph to the case where a spouse or minor child is the beneficiary.<sup>13</sup> Or the first paragraph might be read to extend to all noncreditor beneficiaries because their creditors would merely be denied a windfall. Indeed, literally the exemption can be expanded, as in *Jackson*, to cover all beneficiaries including creditors. But, in any event, the legislature's failure to indicate the scope of the statute left it with anything but a "plain meaning."<sup>14</sup>

Lacking an unambiguous statutory guide, the *Jackson* court

12. Originally the exemption was available to preclude only creditors of the insured. Note 5 *supra*. The benefits exempt, therefore, were the insured's interests in the policy while he lived, and the proceeds going to the decedent's estate if he was survived by a spouse or minor child. For a case holding the latter proposition see *In the Matter of the Estate of Miller*, 121 Cal. 353, 53 Pac. 906 (1898). A beneficiary's proceeds were unaffected since they could not be attached for the insured's debts even without an exemption statute. *North British & Mercantile Ins. Co. v. Ingalls*, 109 Cal. App. 147, 292 Pac. 678 (4th Dist. 1930). In broadening the statute in 1931 to include policy owners other than the insured, the legislature might not have intended to increase the benefits exempt. Irrespective of who the beneficiary is, it seems sound to prevent a creditor from taking without limit something of great value to the debtor to satisfy a relatively lesser debt. The cash surrender value a creditor could get would normally be far less than either the amount the insured had put into the policy or, more significantly, the amount it would cost him to replace it.

13. "The 1947 amendment . . . in its original form as Senate Bill 440, proposed to increase the existing exemption on life insurance from an amount represented by annual premiums of \$500.00 to an amount represented by annual premiums of \$1,000. Prior to passage [*sic*], however, Senate Bill 440 was amended by reinstating the amount of \$500.00 in place of the substituted \$1000, and by adding . . . a second paragraph . . ."

"Analysis of this statutory history shows clearly that the Legislature was willing to increase the amount of life insurance money, benefits and privileges which are exempt . . . so long as the amount of the increase was for the sole benefit and protection of the insured judgment debtor's or defendant's spouse or minor children." 19 Ops. Cal. Att'y Gen. 50, 51-52 (1949).

The *Jackson* court, citing the Attorney General's opinion, acknowledged that the effect of the first paragraph of § 690.19 remained the same as before the 1947 amendment. 56 Adv. Cal. at 192, 363 P.2d at 482, 14 Cal. Rep. at 442.

14. There are other respects in which the statute has no single "plain meaning." It is not clear, for example, whether proceeds taken on surrender of the policy before maturity would be exempt under the statute. Since the protective aspect of life insurance and its relative irreplaceability due to age and health of the insured are the factors making life insurance benefits a proper subject for exemption, protection of the cash surrender value need not be within the policy of the section. *But cf. Hing v. Lee*, 37 Cal. App. 313, 174 Pac. 356 (3d Dist. 1917) (proceeds of matured endowment policy exempt from garnishment). And if the cash surrender proceeds were exempt when taken by the insured, they might logically be exempt if taken by an assignee of the policy. This would be a strange result since a debtor could simply convert cash to exempt property by buying existing policies for their cash surrender value.

should have turned to policy and precedent to support its interpretation.<sup>15</sup> Underlying any question of creditors' rights is the general notion that a man should pay his just debts. But society also has an interest in preventing debtors, particularly surviving family debtors, from being reduced to wards of the state.<sup>16</sup> Perhaps the *Jackson* court could have marshaled other considerations and analyzed them all in a manner that convincingly showed its interpretation of the statutory exemption properly balanced the competing policies and provided a sound legal rule.

The *Jackson* result enabled a creditor beneficiary to convert otherwise available assets into exempt property and defeat his creditors to the extent of 67,000 dollars!<sup>17</sup> If the buyer had lived, the seller's creditors could have levied on the contract installment payments. Absent the insurance provision, the seller would undoubtedly have provided for security through a mortgage or conditional sales contract that would have enabled him to resell the business if payments were stopped because of the buyer's death. His creditors clearly could have reached such an interest. Only because the seller chose life insurance as his security device was he able to defeat his creditors. Under the *Jackson* holding, this device is also available

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15. The court acknowledged that the *Holmes* and *Bowman* decisions dealt only with a widow beneficiary but referred to a dictum in *Prudential Ins. Co. of America v. Beck*, 39 Cal. App. 2d 355, 361, 103 P.2d 241, 244 (1st Dist. 1940), stating that the benefits of the section are not limited to the widow and children. In *Prudential*, an insolvent insured had gratuitously assigned his life insurance policy to the beneficiary. After the insured's death his creditor sought to invalidate the transfer alleging that it was made in fraud of creditors. The court held that since the policy was exempt from attack during the insured's lifetime, the creditors could not possibly be hurt by its transfer. The essence of the holding concerning the exemption statute is simply that an insured is entitled to the exemption during his lifetime—not a very debatable proposition. Even if the *Prudential* beneficiary had availed himself of § 690.19, he was not a creditor beneficiary, hence the result would not compel the *Jackson* holding.

It was argued in *Jackson* that, in view of the *Prudential* case, the addition of the second paragraph in 1947 with no amendment of the first was a tacit legislative approval of the type of result ultimately reached in *Jackson*. Brief of Amicus Curiae in Support of Defendants, p. 7. In view of the narrow holding of the *Prudential* case it is difficult to see how the legislature's approval should have any bearing on the *Jackson* situation, unless the legislature tacitly approves all dicta intervening between statutory amendments.

16. Unless there is no reasonable alternative, this wardship would be a particularly undesirable burden to impose on top of the natural confusion and grief that accompany the loss of a close family member.

17. The *Jackson* decision provides an unscrupulous debtor with the opportunity to defraud his creditors deliberately. He might, for instance, locate an aged and infirm insured and lend him money (which the insured might well need for medical expenses) in return for being named beneficiary of the insured's existing policy. The proceeds when received would be exempt from creditors; and the commercial utility of the transaction, coupled with the insured's lack of fraudulent intent, might negate any creditors' claims of fraudulent transfer. Cf. *In re Dudley*, 72 F. Supp. 943, 945 (S.D. Cal. 1947) (acquisition by insolvent debtor of exempt property with nonexempt funds immediately prior to bankruptcy not ipso facto fraudulent); *Enos v. Picacho Gold Mining Co.*, 56 Cal. App. 2d 765, 774, 133 P.2d 663, 668 (2d Dist. 1943) (transfer for valuable consideration with intent to delay or defraud creditors not void unless transferee shares fraudulent intent).

to preclude creditors of life insurance beneficiaries in other important business situations—home loan insurance plans,<sup>18</sup> partnership cross-purchase insurance plans,<sup>19</sup> and employee-purchased insurance on an employer's life.<sup>20</sup> In each of these instances a substantial portion of property that would normally be available to creditors—property they might well have relied on in extending credit—can be swept from their reach by the death of the insured. Such precarious dependence of creditors' claims on the fortuitous circumstance of a stranger's survival is contrary to the statutory purposes underlying section 690.19, and is unsupported by any rationale based on public policy.

The second question considered in *Jackson* was the extent to which a beneficiary can assert an exemption under the first paragraph of section 690.19 if the annual premium exceeds 500 dollars. The court stated that the statute limited the aggregate exemption; therefore, when there is more than one beneficiary, each is limited to exemption of his own proceeds multiplied by the ratio of 500 dollars to the total annual premium. Although this is a possible reading of the paragraph, the only justification advanced by the court was the obviously circular argument that allowing each beneficiary to claim the full exemption would create an exemption far in excess of that allowed by the legislature. The problem is, of course, to determine what limitation the legislature intended.

If, as the court seems to have decided, the premium paid for the total proceeds payable on death is the basis for limiting a beneficiary's exemption, the court's fears of an exemption far in excess of the legislature's limit must be realized; for under that criterion a creditor beneficiary could claim exemption of insurance proceeds each time one of his insured debtors died. Another disadvantage of this interpretation is that any time a man's life is insured for any purpose other than family protection, the exemption available to his wife and family is proportionately reduced. If, for example, a man paid 1,000 dollars per year for 40,000 dollars of life insurance payable to his wife, her exemption under the first paragraph of sec-

18. This case is analogous to the *Jackson* situation. The mortgagee beneficiary would be receiving installment payments subject to his creditors' claims. On the death of the home buyer, he would receive the lump sum balance subject to exemption under § 690.19.

19. Under such plans, partners insure each other's lives to protect against loss of income on the death of either. The survivor's exempt proceeds replace income that would have been available to creditors had the insured lived.

20. The employee of a small business often buys insurance on the life of the owner, thus protecting him from loss of income if the owner's death disrupts the business. Once again otherwise available income is replaced by exempt insurance proceeds.

tion 690.19 would be 20,000 dollars. But if his employer had paid 2,000 dollars per year for an additional 80,000 dollars of insurance payable to the employer, the wife's exemption would be reduced to 4,000 dollars.<sup>21</sup> There is no indication from the *Jackson* opinion that this controversion of the statute would not occur even if it were unlikely that the employer would claim any exemption.

In deciding the amount of exemption, the court should have considered the probable basis for the limitation as applied to a beneficiary's proceeds. Obviously 500 dollars represents the legislature's adjustment of the competing considerations of satisfying creditors and keeping the debtor beneficiary off relief. The annual cost of other life insurance the decedent may have carried is utterly irrelevant in balancing these considerations. Thus the paragraph should be interpreted to impose the 500-dollar maximum on each debtor beneficiary rather than on the proceeds payable on each death. This interpretation would prevent repeated claims by one beneficiary beyond the 500-dollar limit,<sup>22</sup> and a dependent survivor's exemption would not be reduced by mere speculation as to exemption claims by other beneficiaries.

No reasonable reading of the present limitation can be wholly satisfactory. Although the limitation on the amount of premium paid prevents an insured debtor from placing more than 1,000 dollars per year beyond the reach of his creditors, a beneficiary can receive an exemption of over 200,000 dollars.<sup>23</sup> Obviously an exemption of this magnitude unnecessarily sacrifices the creditors' interests. A more meaningful restriction could be effected by a legislative amendment retaining the premium-based limitation and providing an absolute maximum to prevent exorbitant exemptions. Moreover, the legislature should specify those beneficiaries to

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21. The wife would receive \$20,000 exempt under the second paragraph of § 690.19 since that amount was purchased by \$500 annual premium. The remaining \$100,000 purchased by \$2,500 annual premium would be the basis for an additional exemption under the first paragraph. According to the *Jackson* decision, the wife's exemption would be her proceeds, \$20,000, multiplied by 500/2500, or \$4,000. In the *Jackson* case it seemed to make no difference who paid the premiums; indeed, it would be odd if the exemption of proceeds hinged on such a readily manipulatable factor.

22. This interpretation might also prevent a second claim of exemption when the policy of the statute would warrant such a second claim. For instance, a widow who had claimed the exemption, and later remarried, might need insurance proceeds on the death of her second husband; or a child whose parents are simultaneously killed might need two exemptions. The rarity of such a combination of events, however, renders this a minor objection to an interpretation that prevents unscrupulous commercial creditors from repeatedly claiming the exemption that the *Jackson* decision makes available to them.

23. The *Jackson* case presents a situation where \$200,000 proceeds were purchased by \$883 annual premium. If the face amount had been payable to decedent's wife she would have received that full amount exempt from her creditors' claims.

whom the exemption of the first paragraph runs in order to prevent a subversion of the statutory policy such as that produced by *Jackson*.

EXHIBIT II

[Proposed Bankruptcy Act (July 1973), Section 4-503(c)(5)-(9) and (d)]

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(c) *Other Property.* The following property shall be allowed as exempt in addition to any property allowed as exempt under subdivision (b):

\* \* \* \* \*

(5) the identifiable proceeds or benefits from any life insurance policy if the debtor is the spouse or a dependent of the insured, to the extent the proceeds or benefits are reasonably necessary for the support of the debtor and his dependents;

(6) before or after retirement, such rights as the debtor may have under a profit sharing, pension, stock bonus, annuity, or similar plan which is established for the primary purpose of providing benefits upon retirement by reason of age, health, or length of service, and which is either (A) qualified under section 401(a) of the Internal Revenue Code, or any successor thereto, or (B) established by federal or state statute, to the extent in either case the debtor's interest therein is reasonably necessary for the support of the debtor and his dependents;

(7) disability benefits;

(8) proceeds, benefits, or other rights to which the debtor is entitled as a result of any personal injury or unemployment; and

(9) health aids reasonably necessary to enable the debtor to work or to sustain his health.

(d) *Exemption of Life Insurance Policy with Cash Surrender Value.* A policy or policies of life insurance having an aggregate cash surrender value of not more than \$1,500 payable to the debtor, together with such value, are exempt. If the debtor has a policy or policies with an aggregate cash surrender value in excess of \$1,500, the policies shall nevertheless be exempt if the debtor pays the amount of such excess value to the trustee within 30 days after it has been ascertained and stated to the trustee by the insurer or insurers.

EXHIBIT III

[Maryland--Annot. Code Md. Art. 48A § 385]

**§ 385. Proceeds of life insurance or annuity contracts exempt from creditors.**

The proceeds, including death benefits, cash surrender and loan values, premiums waived, and dividends, whether used in reduction of the premiums or in whatsoever manner used or applied, excepting only where the debtor has, subsequent to the issuance of the policy, actually elected to receive dividends in cash, of any policy of life insurance or under 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. The provisions of this section shall not prohibit any creditor from collecting the amount of any debt out of the proceeds of any life insurance policy pledged by the insured as security for such debt.

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.

EXHIBIT IV

[New York--N.Y. Ins. Law § 166]

§ 166. Exemption of proceeds and avails of certain insurance and annuity contracts-

1. If any policy of insurance has been or shall be effected by any person on his own life in favor of a third person beneficiary or made payable, by assignment, change of beneficiary or otherwise, to a third person, such third person beneficiary, assignee or payee shall be entitled to the proceeds and avails of such policy as against the creditors, personal representatives, trustees in bankruptcy and receivers in state and federal courts of the person effecting the insurance. If any policy of insurance has been or shall be effected by any person upon the life of another person in favor of the person effecting the same or made payable, by assignment, change of beneficiary or otherwise, to such person, the latter shall be entitled to the proceeds and avails of such policy as against the creditors, personal representatives, trustees in bankruptcy and receivers in state and federal courts of the person insured; if the person effecting such insurance shall be the wife of the insured, she shall be entitled to the proceeds and avails of such policy as against her own creditors, trustees in bankruptcy and receivers in state and federal courts. If any policy of insurance has been or shall be effected by any person on the life of another person in favor of a third person beneficiary, or made payable, by assignment, change of beneficiary or otherwise, to a third person, such third person beneficiary, assignee or payee shall be entitled to the proceeds and avails of such policy as against the creditors, personal representatives, trustees in bankruptcy and receivers in state and federal courts of the person insured and of the person effecting the insurance. The term "proceeds and avails" shall include death benefits, cash surrender and loan values, premiums waived, and dividends, whether used in reduction of the premiums or in whatsoever manner used or applied, excepting only where the debtor has, subsequent to the issuance of the policy, actually elected to receive the dividends in cash. The person insured in a case under the first sentence of this subsection or the person effecting the insurance other than the wife of the insured in a case under the second sentence, and the person effecting the insurance under the third sentence thereof, or the executor or administrator of any such persons, or a person entitled to the proceeds or avails of such policy in trust for such persons shall not be deemed a third person beneficiary, assignee or payee. A policy shall be deemed payable to a third person beneficiary if and to the extent that, a facility-of-payment clause or similar clause, in the policy permits the insurer to discharge its obligation after the death of the person insured by paying the death benefits to a third person as herein defined. The provisions of this section shall be applicable whether or not the right is reserved in any such policy to change the beneficiary therein designated, and whether or not the policy is made payable to the person whose life is insured if the beneficiary, assignee or



payee shall predecease such person; and no person shall be compelled to exercise any rights, powers, options or privileges under such policy.

2. No money or other benefits payable or allowable under any policy of insurance against disability arising from accidental injury or bodily infirmity or ailment of the person insured, shall be liable to execution for the purpose of satisfying any debt or liability of the insured, whether incurred before or after the commencement of the disability, except as provided in subsection four, and except further that (a) with respect to debts or liabilities incurred for necessities furnished the insured after the commencement of disability, the exemption shall not include any income payment benefits payable as a result of any disability of the insured, and (b) with respect to all other debts or liabilities incurred after the commencement of disability of the insured, the exemption of income payment benefits payable as a result of any disability of the insured shall not at any time exceed payment at rate of four hundred dollars per month for the period of such disability. When a policy provides for lump sum payment because of a dismemberment or other specific loss of insured, such payment shall be exempt from execution of insured's creditors. The provisions of this subsection shall not affect the assignability of any benefit otherwise assignable.

3. The benefits, rights, privileges and options which, under any annuity contract, heretofore or hereafter issued are due or prospectively due the annuitant, who paid the consideration for the annuity contract, shall not be subject to execution nor shall the annuitant be compelled to exercise any such rights, powers or options contained in said annuity contract, nor shall creditors be allowed to interfere with or terminate the contract, except (a) as provided in subsection four and except (b) that the court may order such annuitant to pay to a judgment creditor or apply on the judgment, in installments, such portion of such benefits, as to the court may appear just and proper, after due regard for the reasonable requirements of the judgment debtor and his family, if dependent upon him, as well as any payments required to be made by the annuitant to other creditors under prior court orders. The benefits, rights, privileges or options accruing under such contract to a beneficiary or assignee shall not be transferable nor subject to commutation, and if the benefits are payable periodically or at stated times, the same exemptions and exceptions contained herein for the annuitant, shall apply with respect to such beneficiary or assignee.

An annuity contract within the meaning of this section shall be any obligation to pay certain sums at stated times, during life or lives, or for a specified term or terms, issued for a valuable consideration, regardless of whether or not such sums are payable to one or more persons, jointly or otherwise, but does not include payments under a life insurance policy at stated times during life or lives, or for a specified term or terms.

4. Every assignment or change of beneficiary, or other transfer, shall be valid, except in cases of transfer with actual intent to hinder, delay or defraud creditors, as such actual intent is defined by article ten of the debtor and creditor law; in case of

transfer with such actual intent, creditors shall have all the remedies provided by said article ten. Where a policy of insurance, theretofore payable to the estate of the insured, is, by assignment, change of beneficiary or otherwise, made payable to a third person beneficiary, such assignment, change of beneficiary or other transfer shall be valid, unless made with such actual intent. Subject to the statute of limitations, the amount of premiums or other consideration paid with actual intent to defraud creditors as provided in said article ten, together with interest on such amount, shall inure to the benefit of creditors from the proceeds of the policy or contract; but the insurer making or issuing such policy or contract shall be discharged of liability thereunder by making payments thereunder in accordance with its terms, or in accordance with any assignment, change of beneficiary or other transfer, unless before any such payment such insurer shall have received written notices, by or on behalf of any such creditor, of a claim to recover any such benefits or portion thereof on the ground of a transfer or payment made with intent to defraud such creditor. Such notice shall specify the amount claimed or such facts as will enable the insurer to ascertain such amount, and shall set forth such facts as will enable the insurer to ascertain the insurance or annuity contract, the person insured or annuitant and the transfers or payments sought to be avoided on the ground of fraud.

5. The term "creditor" as used in this section shall include every claimant under a legal obligation contracted or incurred after the effective date of this chapter.<sup>2</sup> The term "execution" as used in this section shall include execution by garnishee process and every action, proceeding or process whereby assets of a debtor may be subjected to the claims of creditors. The rights of creditors whose claims were contracted or incurred prior to the effective date of this chapter<sup>2</sup> shall be governed by sections fifty-five-a, fifty-five-b and fifty-five-c of chapter twenty-eight of the consolidated laws.<sup>3</sup> This section insofar as it may differ, in form, language or substance, from said sections, is not intended, in any way, to affect the interpretation or construction of said sections as applied to such rights.

6. The provisions of this section applicable to any insurance policy or annuity contract shall likewise apply to group insurance policies or annuity contracts, to the certificates or contracts of fraternal benefit societies, and to the policies or contracts of cooperative life and accident insurance companies.

EXHIBIT V

[Ohio--Ohio Rev. Code § 3911.10]

**§ 3911.10** Proceeds exempt from claims of creditors.

All contracts of life or endowment insurance or annuities upon the life of any person, or any interest therein, which may hereafter mature and which have been taken out for the benefit of, or made payable by change of beneficiary, transfer, or assignment to, the wife or children, or any relative dependent upon such person, or any creditor, or to a trustee for the benefit of such wife, children, dependent relative, or creditor, shall be held, together with the proceeds or avails of such contracts, subject to a change of beneficiary if desired, free from all claims of the creditors of such insured person or annuitant. Subject to the statute of limitations, the amount of any premium upon said contracts, endowments, or annuities, paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the contracts, but the company issuing any such contract is discharged of all liability thereon by the payment of its proceeds in accordance with its terms, unless, before such payment, written notice is given to it by a creditor, specifying the amount of his claim and the premiums which he alleges have been fraudulently paid.

SYNOPSIS

(Pennsylvania--40 Pa. Stat. §§ 514, 515, 517)

**§ 514. Retaining proceeds under policy; anticipating or alienating; rights of retention**

Whenever under the terms of any contract or policy of life insurance, or under any written agreement supplemental thereto, issued by any insurance company, domestic or foreign, lawfully doing business in this State, the proceeds are retained by such company, or directly or otherwise, no person entitled to any part of such proceeds, or any substantial interest therein, because the proceeds shall be permitted to accumulate, anticipate, or alienate or assign in whole or any part thereof, if such prohibition is expressly modified in the terms of such policy or supplemental agreement, or if such holder or assignee has agreed so provided, no payments or interest or principal shall be in any way subject to such person's debts, contracts, or engagements, nor to any judicial processes to levy upon or attach the same for payment thereof; and, further, that such company shall not be required to segregate such funds, but may hold them as a part of its general corporate funds.

**§ 515. Exemption of insurance and annuities**

Any policy or contract of insurance, or annuity, hereafter taken out, or issued by any insurance company, domestic or foreign, lawfully doing business in this Commonwealth, to any solvent citizen thereof, whereof the said insured or purchaser of said annuity shall be the beneficiary or annuitant, not exceeding an amount or return therefrom one hundred dollars (\$100) per month, and any annuity or pension, whether by way of a gratuity or otherwise, granted or paid by any private corporation or employer or out of a trust fund established by any private corporation or employer, or to a retired employee, being a citizen of this Commonwealth, under an agreement, plan or trust instrument which provides that the same shall not be assignable or subject to execution or attachment, shall be exempt and free and clear from the claims of all his or her creditors, and from all legal and judicial processes of execution, attachment, or otherwise, whatsoever.

**§ 517. Exemption of proceeds of life insurance or annuity**

The net amount payable under any policy of life insurance or under any annuity contract upon the life of any person, heretofore or hereafter made for the benefit of or assigned to the spouse 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 the passage of this act, whether or not the right to change the named beneficiary is reserved by or permitted to such person.

EXHIBIT VII

[South Dakota--S.D. Rev. Code § 43-45-6]

43-45-6. Proceeds of life insurance payable to estate of decedent--Rights of surviving spouse or minor children--Amount of exemption--Payment discharging insurer from liability.--The proceeds of any insurance upon the life of any person residing in this state, at the time of his death and who leaves a surviving widow, husband, or minor child or children, payable upon his death to his estate, executor, or administrator, and not assigned to any other person, shall, to any amount not exceeding ten thousand dollars, inure to the use of such surviving widow, husband, minor child or children; and such amount shall not be subject to the payment of any debt of such decedent, or of such surviving widow, husband, minor child or children. Whenever the proceeds of such insurance become payable and the insurer makes payment thereof to the administrator or executor of the estate of such person, such payment shall fully discharge the insurer from all claims under the policy or contract, and such insurer need not follow the distribution of such payment.