



Life Insurance in Bankruptcy and Judgment Enforcement Matters

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Two Illinois statutes have serious impact on the treatment of life insurance in bankruptcy and judgment enforcement matters. The first of these is in the Insurance Code and provides:

All proceeds payable because of the death of the insured and the aggregate net cash value of any or all life and endowment policies and annuity contracts payable to a wife or husband of the insured, or to a child, parent or other person dependent upon the insured, whether the power to change the beneficiary is reserved to the insured or not, and whether the insured or his estate is a contingent beneficiary or not, shall be exempt from execution, attachment, garnishment or other process, for the debts or liabilities of the insured incurred subsequent to the effective date of this Code, except as to premiums paid in fraud of creditors within the period limited by law for the recovery thereof.

215 ILCS 5/238(a). The second is the section of the Illinois Code of Civil Procedure on personal property exemptions, which exempts from enforcement of judgments, among other things:

(f) All proceeds payable because of the death of the insured and the aggregate net cash value of any or all life insurance and endowment policies and annuity contracts payable to a wife or husband of the insured, or to a child, parent, or other person dependent upon the insured, whether the power to change the beneficiary is reserved to the insured or not and whether the insured or the insured's estate is a contingent beneficiary or not;

...

(h) The debtor's right to receive, or property that is traceable to:

...

(3) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor or a dependent of the debtor[.]

735 ILCS 5/12-1001.

Although these statutes on their face simply exempt the stated property from the enforcement of judgments, pursuant to 11 U.S.C. § 522(b)(3) and 735 ILCS 5/12-1201 they also apply to determine whether property is exempt in bankruptcy cases for most Illinois residents.

Issues involving these laws have arisen before the bankruptcy courts in several fact circumstances in recent years, resulting in several judicial embellishments of note:

- ▶ Bankruptcy Judge Kenneth J. Meyers of the Southern District has ruled that Chapter 7 debtors are not entitled to exempt the cash surrender value of policies the benefits on which are payable to their non-dependent children or to parents. *In re Wheeler*, 227 B.R. 810 (Bankr. S.D. Ill. 1998). Similarly, Judge Meyers has held that the value of a policy death benefits on which were payable to the debtor's non – dependent cousin was not exempt. *In re Ellis*, 274 B.R. 782 (Bankr. S.D. Ill. 2002).
- ▶ Bankruptcy Judge Larry L. Lessen in the Central District has ruled that life insurance proceeds resulting from the husband's death are entirely exempt, whether necessary for the debtor-wife's support or not, because they are "proceeds payable because of the death of the insured." *In re Bird*, 288 B.R. 546 (Bankr. C.D. Ill. 2002). In *In re Stilwell*, 2004 WL 2708512 (Bankr. C.D. Ill. 2004), and *In re Ashley*, 317 B.R. 352 (Bankr. C.D. Ill. 2004), Bankruptcy Judges Gerald D. Fines and Thomas L. Perkins, both also of the Central District, have concurred. On appeal in *Stilwell*, these decisions have been blessed by the United States District Court for the Central District. *In re Stilwell*, 31 B.R. 471 (C.D. Ill. 2004).
- ▶ In *In re Bunting*, 322 B.R. 852 (Bankr. C.D. Ill. 2005), the debtor's mother had owned an insurance policy providing that monthly death benefits of \$1000 be paid to the debtor and his sister. When the debtor filed bankruptcy, he was entitled to some 24 more payments of \$500. Because the debtor could not show that he was a dependent of his mother, Judge Perkins thwarted the mother's estate plan and ordered that the money be turned over to the Chapter 7 Trustee for the benefit of the creditors.

On a distinguishable point, in *Ellis* Judge Meyers also ruled that a debtor could not exempt the cash surrender value in a whole life insurance policy that provided for payment to the debtor of an annuity when the debtor reached age 65. Judge Meyers ruled that the policy was not a "retirement plan" within the scope of another exemption statute, 735 ILCS 5/12-1006. *In re Ellis*, 274 B.R. 782 (Bankr. S.D. Ill. 2002).

Insurance exemption issues can arise in state courts also. For example, in *Dowling v. Chicago Options Assoc., Inc.*, 365 Ill.App.3d 341, 847 N.E.2d 741 (1st Dist. 2006), the Appellate Court faced whether a judgment debtor who had a life insurance policy payable to a trust for the benefit of his children could thereby keep its considerable cash surrender value out of the hands of a creditor. The court noted that the legislature had provided that for cash surrender values to be exempt, proceeds were to be payable to "a wife or husband of the insured, or to a child, parent, or other person dependent on the insured" (735 ILCS 5/12-1001(f), quoted above), and that it did not include non-person entities, such as trusts, in its list of beneficiaries that would enable a policy to have exempt status. The court then stated, "Looking at the four corners of Davis's life insurance policy, it is clear that the beneficiary listed, the 'Davis Trust,' is not 'a wife or husband of the insured, or a child, parent, or other person dependent on the insured.'" The court ruled the policy was not exempt, without considering the age of the children or whether they were dependent on the debtor.

The above cases teach that those whose financial affairs are not strong, and those such as Mr. Davis who engage in risky lines of work which may result in substantial change in one's financial status, should pay particular attention to their life insurance planning. Failure to do so may mean that funds available through life insurance, whether by death benefits or by cash surrender, may not be protected from bankruptcy trustees and levying creditors.

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