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THE INDIANA LIFE INSURANCE PROCEEDS EXEMPTION STATUTE AND THE LAW OF FRAUDULENT CONVEYANCES

Statutes exempting life insurance proceeds from creditors' actions¹ embody the principle that "the support of wife and children as a positive obligation in law as well as morals should be extended to protect them from destitution after the debtor's death, by permitting him . . . to devote a moderate portion of his earnings to keep on foot a security for support. . . ."² The competing principle that "persons must be just before they are generous and . . . debts must be paid before gifts are made"³ is embodied in fraudulent conveyance statutes.⁴

The exemption and fraudulent conveyance statutes conflict where an insured has purchased or paid the premiums on a life insurance policy while insolvent and where an insured has, while insolvent, transferred to an exempt beneficiary the beneficial interest in a life insurance policy originally payable to a non-exempt beneficiary. To resolve this conflict and determine whether the insured has defrauded his creditors, a court must decide two fundamental legal questions. The first is whether fraud can be inferred from the purchase, payment of premiums, or transfer during insolvency or must be proven by additional evidence of actual intent to defraud. The second is what measure of recovery is permitted if fraud is proven.⁵ Indiana has both fraudulent conveyance statutes⁶ and

1. The first exemption statute was the Verplanck Act, N.Y. Laws 1840, ch. 80, which permitted a married woman to insure the life of her husband and obtain the proceeds free from the claims of her husband's creditors. Massachusetts followed New York in 1844 with a statute that accorded similar privileges to beneficiaries other than married women. Mass. Laws 1844, ch. 82. Tennessee continued the early experimentation in 1846 by combining exemption and distribution provisions. Tenn. Laws 1846, ch. 216. Ohio concluded the early phase of the statutory development in 1847 by exempting life insurance proceeds effected by a husband for the benefit of his wife. Ohio Laws 1847, at 53. These early statutes became basic prototypes for other jurisdictions. Today all states, with the apparent exception of Utah, have similar exemption provisions, the Indiana statute being enacted in 1925.

2. *Central Nat'l Bank v. Hume*, 128 U.S. 195, 211 (1888).

3. *Freeman v. Pope*, L.R. 5 Ch. 538, 540 (1870).

4. The first statute concerning fraudulent conveyances was 13 Eliz. c. 5 (1571). Then life insurance was considered a chose in action and, therefore, not subject to the reach of the statute. *Dundas v. Dutens*, 1 Ves. 196, 30 Eng. Rep. 298 (1790). It remained for The Insolvent Debtor's Act to bring life insurance within the purview of the law of fraudulent conveyances. 1 & 2 Vict. c. 110 (1838). Today all states have enacted similar statutes, Indiana's being enacted in 1852.

5. In the premiums paid during insolvency problem possible recoveries are: the amount of the premiums paid during insolvency, an aliquot share of the proceeds (that proportion of the proceeds that the premiums paid in fraud of creditors is to the entire amount of premiums expended for the policy), or the entire proceeds. When a transfer is involved the recovery may be either the amount of the premiums paid during insolvency, the cash surrender value at the time of transfer, or the entire proceeds. Generally

an exemption statute,⁷ but no Indiana appellate court has considered the relationship between them. The purpose of this note is to suggest how the courts might interpret the statutes as they relate to each other and to evaluate this interpretation.

The Indiana Position Before Adoption of the Exemption Statute

Prior to the enactment of the exemption statute in 1924, Indiana courts afforded protection to the families of deceased debtors without the aid of a life insurance proceeds exemption statute by permitting debtors to maintain a reasonable amount of life insurance free from the claims of their creditors.

It is clear that the doctrine of constructive fraud was not applied in Indiana before adoption of the exemption statute. A fraudulent intent was not inferred from the mere fact of the insolvency of the insured. The earliest cases were *Foster v. Brown*⁸ and *Pence v. Makepeace*,⁹ both decided by the Indiana Supreme Court in the May term of 1879. In *Foster* the complaint averred that the insured had paid premiums while he was insolvent. The court held that fraud in obtaining and maintaining the policies during insolvency would not be presumed; since there were no other facts that showed a fraudulent intent, the court dismissed the complaint. In *Pence* the complaint alleged that the insured had paid premiums

these recoveries have been limited by the amount of the debt. But, under the constructive trust theory, a few courts have given the creditors the entire proceeds irrespective of their relation to the amount of the debt. See *Fearn v. Ward*, 80 Ala. 555, 2 So. 114 (1886).

6. The applicable Indiana statutes follow:

"All conveyances or assignments, in writing or otherwise . . . of goods or things in action . . . made or suffered with the intent to hinder, delay or defraud creditors . . . shall be void as to the persons sought to be defrauded." Ind. Rev. Stat. 1852, ch. 42, § 17, IND. ANN. STAT. § 33-408 (Burns 1949 Repl.).

"All deeds of gift, conveyances, transfers, or assignments, verbal or written, of goods or things in action, made in trust for the use of the person making the same, shall be void as against creditors, existing or subsequent, of such person." Ind. Rev. Stat. 1852, ch. 42, § 18, IND. ANN. STAT. § 33-409 (Burns 1949 Repl.).

"The question of fraudulent intent, in all cases arising under the provision of this act, shall be deemed a question of fact. . . ." Ind. Rev. Stat. 1852, ch. 42, § 21, IND. ANN. STAT. § 33-412 (Burns 1949 Repl.).

7. Ind. Acts 1935, ch. 162, § 155, IND. ANN. STAT. § 39-4210 (Burns 1965 Repl.).

The pertinent provisions follow:

All policies of life insurance upon the life of any person, which may hereafter mature, and which have been or shall be taken out for the benefit of, or bona fide assigned to the wife or children, or any relative dependent upon such persons, or any creditor, shall be held, subject to change of beneficiary from time to time, if desired, for the benefit of such wife or children, or other relative, or creditor, free and clear from all claims of the creditors of such insured person; and the proceeds or avails of all such life insurance shall be exempt from all liabilities from any debt or debts of such insured person.

8. 65 Ind. 234 (1879).

9. 65 Ind. 345 (1879).

on a policy while insolvent and that, therefore, the beneficiary held the policy as a quasi trustee for the benefit of creditors. The court avoided deciding this issue, but it indicated that the creditor's position was not well taken.¹⁰ The court said that when a life insurance policy has been taken out by a husband and father on his own life for the apparent purpose of providing for the comfort and support of his family after his death, clear and convincing proof of fraudulent intent would be necessary to divert the insurance from its intended purpose.¹¹

The doctrine of constructive fraud has also been rejected in cases involving a transfer during insolvency of rights from non-exempt to exempt beneficiaries. In *Johnson v. Alexander*¹² the insured had assigned a policy payable to his personal representative to certain creditors in return for their agreement to pay the premiums on the policy and, upon the insured's death, to pay the proceeds in excess of their claims to the heirs of the insured. After the insured's death, the assignee-creditors paid the balance of the proceeds to the heirs. An unsecured creditor contended the excess proceeds were payable to the insured's estate on the ground that the assignment was a gift to the heirs during insolvency and therefore a fraudulent conveyance. The court rejected this contention and held that actual intent must be proven. The same result was reached in *State ex rel Wright v. Tomlinson*,¹³ where the insured, while insolvent, assigned to his wife a policy originally payable to his estate. The court held that mere evidence of an assignment while insolvent is not sufficient to establish a fraudulent intent.

The Indiana courts' rejection of the constructive fraud doctrine found support in the United States Supreme Court's decision in *Central Nat'l Bank v. Hume*.¹⁴ The court said that a man should be entitled to devote a moderate portion of his earnings to the support of his family, at least to the extent of requiring that the fraudulent intent be clearly shown. In determining intent, both the Indiana court and the United States Supreme Court looked to the reasonableness of the amount of premiums paid by the insured. In all of these cases the courts found that the amount of premiums was reasonable, but in none of them did the courts indicate what an unreasonable amount might be.

Since fraudulent intent was not established in any of the Indiana

10. The insolvency issue was not tried in the court below nor presented in the record on appeal. The Indiana Supreme Court instead based its decision for the beneficiary on the failure of the creditor to prove that the beneficiary had assigned the policy to him.

11. *Pence v. Makepeace*, 65 Ind. 345, 359 (1879).

12. 125 Ind. 575 (1890).

13. 16 Ind. App. 662 (1896).

14. 128 U.S. 195 (1888).

cases, the courts' expressions on the permissible quantum of recovery where fraud is established are dicta. In both the "transfer" cases and the "premiums paid during insolvency" cases the courts emphatically expressed their opinion that if intent were proven, the creditors' recovery should be limited to the sum of the premiums paid by the insured during his insolvency.¹⁵ In *Pence* the Indiana Supreme Court was uncertain whether recovery should be allowed even on a clear showing of fraudulent intent, but suggested that if recovery were permitted, it should be limited to the sum of the premiums paid during insolvency.¹⁶ In the transfer cases, *Johnson* and *Tomlinson*, the courts were more certain that recovery should be permitted if intent were proven, but also indicated that recovery should be limited to the sum of the premiums paid during insolvency.¹⁷

*The Probable Indiana Position After
the Adoption of the Exemption Statute*

It is probable that the present Indiana position is: where there is a premium payment or purchase by an insolvent, there can be no recovery by a creditor so long as the policy designates an exempt beneficiary; and where there is a transfer by an insolvent from a non-exempt to an exempt beneficiary there must be proof of actual intent to defraud, and the recovery is limited to the amount of the premiums paid during insolvency.

When an Indiana court finds it necessary to resolve the conflict between the state's fraudulent conveyance statutes and its exemption statute, it can find guidance in the experience of those states that have similar exemption statutes. There are twenty states including Indiana with statutes that do not expressly speak of fraud.¹⁸ These statutes may be classified as to whether they exempt as a beneficiary the insured, his estate, or his personal representative. The transfer problem cannot arise in those states where the insured, his estate, and his personal representative are exempt, since the transfer would be from one exempt beneficiary

15. When a recovery is limited to the sum of the premiums paid during insolvency, interest is computed thereon and added to the sum of the premiums.

16. *Pence v. Makepeace*, 65 Ind. 345, 360 (1879).

17. *Johnson v. Alexander*, 125 Ind. 575, 579 (1890); *State ex rel. Wright v. Tomlinson*, 16 Ind. App. 662, 678 (1896).

18. See CAL. CIV. PROC. CODE § 690.19; COLO. REV. STAT. ANN. § 77-2-2(m) (1963); FLA. STAT. § 222.13 (1961); IDAHO CODE ANN. § 11-205(9) (1947); IOWA CODE ANN. § 511.37 (1949); KAN. GEN. STAT. ANN. § 40-414 (1963); LA. REV. STAT. § 22:647 (1958); MISS. CODE ANN. § 308 (1942); MO. ANN. STAT. § 376.560 (1949); MONT. REV. CODES ANN. § 93-5814(7) (1947); NEB. REV. STAT. § 44-371 (1960); N.M. STAT. ANN. § 24-5-3 (1953); N.D. CENT. CODE § 26-10-18 (1959); PA. STAT. ANN. tit. 40, § 517 (1954); S.C. CODE ANN. § 37-169 (1962); S.D. CODE § 31.1509 (1939); TENN. CODE ANN. § 56-1108 (1955); TEX. INS. CODE art. 21.22 (1963); VT. STAT. ANN. tit. 8, § 3705 (1958).

to another. There are six states besides Indiana¹⁹ that do not exempt these beneficiaries.²⁰ An examination of the case law of these six states suggests that the probable Indiana position will be that stated above.²¹

The exemption statute that is most similar to Indiana's is the Pennsylvania statute,²² which was enacted in 1923, two years after Pennsylvania's adoption of the Uniform Fraudulent Conveyance Act.²³ The premiums paid during insolvency problem has long been distinguished from the transfer problem in Pennsylvania.²⁴ *Irving Bank v. Alexander* represents the present Pennsylvania position concerning the payment of premiums during insolvency.²⁵ The court not only refused to permit the creditor to reach the proceeds of policies amounting to \$500,000, but also denied his right to recover the amount of the premiums paid during insolvency. The court reasoned that creditors were without a remedy since a provision of Pennsylvania's 1911 exemption statute²⁶ that permitted a creditor to reach premiums paid by an insured with intent to defraud creditors was omitted from subsequent exemption acts.²⁷ Although sufficient facts were not averred in the complaint to raise the issue of actual intent, a federal district court later held that the statute granted an ab-

19. The Indiana statute exempts the wife, children, dependent relative, and creditor of the insured. See note 7 *supra*.

20. Kansas, Missouri, Nebraska, Pennsylvania, South Carolina, and Vermont are the six states.

21. No applicable case law on the problems under consideration was found for interpretation of the Vermont and South Carolina statutes.

22. The Pennsylvania exemption statute states: "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 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 the passage of this act, whether or not the right to change the named beneficiary is reserved by or permitted to such person." PA. STAT. ANN. tit. 40, § 517 (1954).

A comparison with the Indiana statute (see note 7 *supra*) reveals the following differences: Pennsylvania exempts annuity contracts and Indiana does not; Indiana exempts designated creditors and Pennsylvania does not; and Indiana exempts "bona fide" assignments while Pennsylvania omits "bona fide." For purposes of analogy these differences are not of sufficient import to detract from any conclusions that may be drawn.

23. PA. STAT. ANN. tit. 39, §§ 351-63 (1954). The Uniform Fraudulent Conveyance Act is presently the law in twenty jurisdictions but not in Indiana. The primary distinction between the Uniform Fraudulent Conveyance Act and other fraudulent conveyance statutes as typified by the Indiana statute is that under the Uniform Fraudulent Conveyance Act constructive fraud is sufficient to establish the requisite intent, *i.e.*, the mere fact of a purchase or premium payment, or transfer while insolvent establishes the *prima facie* case.

24. See, *e.g.*, Appeal of Elliot's Ex'rs, 50 Pa. 75 (1865).

25. 280 Pa. 466, 124 Atl. 634 (1924). The same position had been taken as early as 1881 in *McCutcheon's Appeal*, 99 Pa. 133 (1881).

26. Laws of Pa. 1911, 581, 595 (§ 27).

27. Laws of Pa. 1915, No. 145; Laws of Pa. 1919, No. 128; Laws of Pa. 1923, No. 335.

solute exemption even if actual intent to defraud were proven.²⁸ Thus the present Pennsylvania position is that when the alleged fraud consists of the payment of premiums during insolvency, the exemption statute takes precedence over the fraudulent conveyance statute and creditors are precluded from any recovery.

The Missouri courts have reached a contrary result, permitting recovery where fraud is present. However, this result is attributable to the nature of the Missouri exemption statute, which designates a limit of \$500 per year that may be expended on premiums for insurance beyond the reach of creditors.²⁹ The Missouri courts have held that if the decedent debtor's premiums were below the statutory limit there can be no consideration of fraud; but if more than \$500 is expended in one year, there is a presumption of fraudulent intent and the creditors may reach all premiums expended over that amount.³⁰ By designating a single criterion, payment of premiums above \$500, for the determination of fraud, the legislature has implied that fraudulent conveyance concepts are to be retained in the operation of the exemption statute.

The Ohio statute, although it expressly mentions fraud, might be considered in interpreting the Indiana exemption statute. Authorities have indicated that the Indiana exemption statute was taken from a 1913 Ohio act.³¹ The Indiana exemption statute is a verbatim reproduction of the first two sections of the 1913 Ohio act; but the Ohio statute includes a third section, omitted from the Indiana statute, which enables creditors to reach premiums fraudulently paid.³² The Indiana General Assembly's omission of the third section of the Ohio act implies that a complete exemption is intended when the alleged fraud consists of a payment of premiums during insolvency. If the Indiana General Assembly had desired to retain fraudulent conveyance concepts in this situation, it would have copied the third section of the Ohio act.

Thus, the position that the Pennsylvania courts have taken on that

28. *In re Silansky*, 21 F. Supp. 41, 42 (E.D. Pa. 1937): "the purpose of the Pennsylvania Act which grants an absolute exemption of amounts payable under life insurance policies, regardless of whether the payments . . . were made with intent to defraud creditors."

29. Mo. ANN. STAT. § 376.560 (1949).

30. *Pullis v. Robison*, 73 Mo. 201 (1880); *Sternberg v. Levy*, 159 Mo. 617, 60 S.W. 1114 (1901); *Kiely v. Hickcox*, 70 Mo. App. 617 (1897).

31. Ohio Laws 1913, at 558. The position that the Indiana exemption statute is a duplicate of Ohio's was taken by the Seventh Circuit in *In re Fogel*, 164 F.2d 214 (7th Cir. 1947), and by Riesenfeld, *Life Insurance and Creditors' Remedies in the United States*, 4 U.C.L.A.L. REV. 583 (1957).

32. The Ohio courts have held that a recovery is permitted when fraud is proven and that fraud means constructive fraud. *Child v. Graham*, 8 Ohio Dec. Reprint 294 (1882) (also printed in 7 WEEKLY CINCINNATI LAW BULL. 43); *John Weenink & Sons v. Bland*, 73 Ohio App. 67, 54 N.E.2d 426 (1943).

state's exemption statute and the omission in the Indiana exemption statute of an express remedy for a defrauded creditor point to a complete exemption in the premiums paid during insolvency problem. The Indiana position before adoption of the exemption statute was at most one step removed. The dicta in *Pence* was equivocal, suggesting that if fraud were proven a recovery of the sum of the premiums paid during insolvency was permissible, but also suggesting that the court was unsure that any recovery was possible. By adopting an exemption statute the General Assembly may have intended to remove this ambiguity and to place debtors in a better position than they were before the statute was adopted.

The Indiana exemption statute's omission of any reference to fraud does not compel the courts to construe the statute as granting a complete exemption when there is a transfer during insolvency. An indication of the probable Indiana position on the transfer problem can also be found in the experience of states with similar exemption statutes.

The Kansas courts have not decided the transfer problem, but the Kansas Supreme Court's construction of the purpose of the exemption statute indicates that the statute does not grant a complete exemption. In *Exchange State Bank v. Poindexter* the court said: "the exemption of insurance money to the beneficiary is no more sacred in this state than the exemption of the homestead, and where the element of fraud enters into the transaction by which the homestead is acquired, the exemption fails."³³

In the transfer problem, unlike the premiums paid during insolvency problem, a statutory limit on premiums does not preclude consideration of fraud. Nebraska, like Missouri, has such a limit.³⁴ In *Laborde v. Farmer's State Bank*³⁵ an insolvent insured had changed the beneficiary from his estate to his wife two days before his death. The wife contended that she was entitled to that share of the proceeds that the \$500 statutory limit would purchase, but the Nebraska court held that she was entitled to none of the proceeds, reasoning that the change of beneficiary was an attempt to exempt a part of the proceeds which otherwise could have been reached by creditors. The court said that the transfer was presumptively fraudulent and that the burden of proof was upon the beneficiary to establish the validity of the transaction, even though the Nebraska fraudulent conveyance act requires proof of actual intent.³⁶ In contrast the Missouri court held in a similar case that the transfer was

33. 137 Kan. 101, 105, 19 P.2d 705, 707 (1933).

34. NEB. REV. STAT. § 44-371 (1960).

35. 116 Neb. 33, 215 N.W. 559 (1927).

36. This corresponds to Ind. Rev. Stat. 1852, ch. 42 § 21, IND. ANN. STAT. § 33-412 (Burns 1956 Repl.), quoted in note 6 *supra*.

valid,³⁷ but permitted the creditors to reach the amount of the premiums expended in excess of \$500.

The Pennsylvania courts considered the transfer problem in *Fidelity Trust Co. v. Union Nat'l Bank*³⁸ where the insured had purchased \$250,000 of life insurance naming his estate as the beneficiary and while insolvent had changed the beneficiary to a trustee for the benefit of his wife and children. The court found sufficient facts to support the trial court's finding of fraudulent intent; however, the court said that, even disregarding evidence of actual fraudulent intent, the insolvency of the insured rendered the transaction constructively fraudulent under the Uniform Fraudulent Conveyance Act in force in Pennsylvania. The creditors were allowed to reach the entire proceeds of the policies fraudulently conveyed,³⁹ perhaps because the wife and children were already adequately provided for by another insurance trust of \$500,000.

The 1933 decision in *Fidelity Trust* was consistent with the earlier Pennsylvania decisions in *Appeal of Elliot's Ex'rs*⁴⁰ and *McKown's Estate*,⁴¹ both decided before enactment of the 1911 exemption statute⁴² granting a remedy to defrauded creditors.⁴³ As noted earlier, this remedy was omitted from later exemption statutes beginning in 1915,⁴⁴ a fact that the Pennsylvania Supreme Court gave as a reason for its 1924 decision in the *Irving Bank* case that when the alleged fraud consisted of a payment of premiums during insolvency, the creditor is without a remedy.⁴⁵ But it appears significant that the Pennsylvania Supreme Court in *Fidelity Trust* did not reach the same conclusion when a transfer during insolvency was involved, even though the court could have followed the reasoning in *Irving Bank* and concluded that the remedy for defrauded creditors had also been abandoned in the transfer cases.⁴⁶ Thus Penn-

37. *Judson v. Walker*, 155 Mo. 166, 55 S.W. 1083 (1900).

38. 313 Pa. 467, 169 Atl. 209 (1933).

39. Creditors were denied recovery in two similar cases that were decided one year later. However, these decisions are better based on reasons that involve the peculiar circumstances of the cases rather than a strict analysis of the relationship between the exemption and fraudulent conveyance statutes. See *Stutzman v. Fidelity Mut. Life Ins. Co.*, 315 Pa. 47, 172 Atl. 302 (1934), where the wife had joined previously with the insured in an assignment of a policy payable to her and *Potter Title & Trust Co. v. Fidelity Trust Co.*, 316 Pa. 316, 175 Atl. 400 (1934), where the insured originally had policies payable to his wife and children and thereafter executed an insurance trust for the benefit of them, a transfer that did not involve non-exempt beneficiaries.

40. 50 Pa. 75 (1865).

41. 198 Pa. 96, 47 Atl. 1111 (1901).

42. Laws of Pa. 1911, 581, 595 (§ 27).

43. Prior to 1911 the Pennsylvania exemption statute omitted mention of fraud. See, e.g., Laws of Pa. 1868, No. 64.

44. Laws of Pa. 1915, No. 145. Succeeding exemption statutes continued to omit the mention of fraud.

45. See note 25 *supra* and accompanying text.

46. *Fidelity Trust v. Union Nat'l Bank*, 313 Pa. 467, 169 Atl. 209 (1933).

sylvania has always afforded a remedy when the fraud consists of a transfer during insolvency, and the presence or absence of express statutory language pertaining to fraud is of no significance.

It is consistent that a recovery is permitted in the transfer problem and denied in the premiums paid during insolvency problem. The specie of fraud involved in the transfer problem is more acute. The creditor may have been influenced by the availability of insurance proceeds where, at the time the debt was created, the policy was payable to the insured, his estate, or his personal representative.⁴⁷ In addition the fraud involved is more blatant when the approach of financial difficulty is accompanied by a sudden transfer of assets that previously could be reached by creditors. If the insured had as his primary purpose the protection of his family, he would originally have had the policy made payable to them.

The Indiana exemption statute expressly exempts "bona fide assignments."⁴⁸ This indicates that at least fraudulent transfers by assignment are not exempt, and, if logically extended, it may indicate that a fraudulent change of beneficiary is not exempt. There is little practical difference between an assignment and a change of beneficiary. Although an assignment is a transfer of complete ownership and a change of beneficiary is not, the family relationship is such that the husband retains effective control of the policy in either event. At any time after assignment, the wife could reassign the policy to the husband, thus equalizing the practical consequences of the two methods of transfer.

Thus, if the Indiana exemption statute does not grant a complete exemption in the transfer during insolvency situation, issues of intent and quantum of recovery will arise. The Indiana courts will require proof of actual intent. The constructive fraud doctrine has never obtained in Indiana and by statute actual intent is required.⁴⁹ States like Pennsylvania that have indicated that constructive fraud may be sufficient are states that have enacted the Uniform Fraudulent Conveyance Act, which requires only constructive fraud.

The recovery will be limited to the sum of the premiums paid during insolvency. Pennsylvania permits the creditor to reach the entire proceeds, a better result since the creditor is rarely made whole by a recovery limited to premiums paid during insolvency. However, the Indiana courts have indicated by dicta in *Johnson* and *Tomlinson* that the re-

47. The reliance factor is probably small in these situations, at least in transactions involving professionals; however, it seems probable that reliance is present in a few situations, particularly those involving the non-professional creditor.

48. See note 7 *supra*.

49. Ind. Rev. Stat. 1852, ch. 42 § 21, IND. ANN. STAT. § 33-412 (Burns 1949 Repl.), quoted in note 6 *supra*.

covery must be limited to the amount of the premiums paid during insolvency, and it would be extremely difficult to imply that the legislature intended to enhance creditors' rights by the adoption of an exemption statute.

The Effect of the Indiana Position in Bankruptcy Proceedings

The problem of fraudulent conveyances of life insurance also arises in bankruptcy. Section 70a(5) of the Federal Bankruptcy Act provides that the life insurance policy of a bankrupt passes to the trustee unless the bankrupt pays to the trustee an amount equal to the existing cash surrender value of the policy.⁵⁰ Should the bankrupt fail to save the policy in the manner proscribed, the trustee under powers granted in section 70a(3) may exercise the cash surrender option of the policy.⁵¹ The importance of sections 70a(3) and 70a(5) has been qualified by section 6 which, in effect, provides that the trustee can reach the cash surrender value only if the state exemption law so permits.⁵²

Indiana exempts the "proceeds or avails" of life insurance policies.⁵³ Since "proceeds or avails" includes the cash surrender value, the Indiana exemption statute does not permit the trustee to exercise the cash surrender option.⁵⁴ Although the cash surrender value is exempt, the trustee might attempt to recover when a fraudulent conveyance can be established. The recovery would be limited to the sum of the premiums paid in fraud of creditors where there was a transfer during insolvency, as it would be in an Indiana court proceeding under the fraudulent conveyance statutes. However, since the cash surrender value is exempt, a judgment can only be satisfied from the proceeds of a matured policy; therefore no collection is possible prior to the death of the insured.⁵⁵ To ensure collection after maturity a lien could be impressed on the policy under section 70e of the Federal Bankruptcy Act.⁵⁶

50. Bankruptcy Act § 70a(5), 30 Stat. 565 (1898), 11 U.S.C. § 110a(5) (1964).

51. Bankruptcy Act § 70a(3), 30 Stat. 565 (1898), 11 U.S.C. § 110a(3) (1964).

52. Bankruptcy Act § 6, 30 Stat. 548 (1898), 11 U.S.C. § 24 (1964).

53. See note 7 *supra*.

54. In the Matter of Summers, 253 F. Supp. 113 (N.D. Ind. 1966). The trustee also unsuccessfully argued that the cash surrender value was not exempt because the policy had not matured. He contended that a policy is matured and thus exempt only when the insured has died or irrevocably designated an exempt beneficiary. The court countered by stating that the clear intent of the statute was to protect the family of the bankrupt while he was alive as well as after death and express language of the statute granted the exemption even though the insured had retained the right to change the beneficiary.

55. Doethlaff v. Penn Mut. Life Ins. Co., 117 F.2d 582 (6th Cir. 1941); Greiman v. Metropolitan Life Ins. Co., 96 F.2d 823 (3d Cir. 1938) (N.J.).

56. Bankruptcy Act § 70e, 30 Stat. 565 (1898), 11 U.S.C. § 110e (1964). This remedy was suggested by Professor Riesenfeld. Riesenfeld, *supra* note 31, at 616.

Policy Considerations and Alternatives

The probable Indiana positions give preference to the principle of family protection over that of just payment of debts. However, there may be alternative positions that equitably balance both principles.

One alternative is the Indiana position before adoption of the exemption statute: permitting creditors to recover all above a reasonable amount in both the transfer and premiums paid during insolvency situations. This requires that the court determine what is reasonable according to the circumstances of the case, a task that some feel the court is uniquely suited to perform. Factors that a court might consider in making this determination are: the age of the widow and children, the number of children, the ability of these survivors to find gainful employment, the amount of the deceased's income, and the amount previously expended by the deceased to support his family. In effect a reasonable amount has become that amount that is sufficient to support the family according to the station in life which they enjoyed before deceased's death.

The alternative most favorable to debtors is a complete exemption in both the premiums paid during insolvency and the insolvent transfer situations. The courts would disregard issues of fraud and direct the entire proceeds of the policies to those exempt beneficiaries named in the policy. This alternative places supreme importance on family protection and does so to the exclusion of all other policy considerations.

The probable Indiana positions and the two alternatives thus far examined produce similar results. They place primary emphasis on the well-being of the family at the expense of the creditor. Implicit in these positions is a social argument that it is better for creditors to bear or at least share the burden of family security rather than for the family to become paupers or wards of the state. But the courts and legislatures have developed inappropriate standards to protect the family. Instead of exempting the amount that the survivors need to evade poverty and maintain a comfortable life, the courts have limited the creditor's recovery, if any, to amounts paid or transferred in fraud of creditors. Very often the creditors recover considerably less than the full amount of the debt (or nothing under the probable Indiana position when the fraud consists of payments of premiums during insolvency) even though the remaining insurance proceeds are far in excess of what would be required to adequately provide for the family. This seems unfair. There is good reason to provide adequate support for the family, but little reason to exempt more than is adequate for support.

The nature of today's life insurance policies indicates that creditor

protection should be given greater consideration.⁵⁷ The exemption statutes originated before cash surrender, loan, and change of beneficiary options became a part of the ordinary life insurance contract. If family protection is to be assigned such great importance, it should be observed that exercising the cash surrender, loan, and change of beneficiary options can destroy family protection no less than permitting creditors to reach the policies. More significantly, these options present an opportunity for a debtor to screen his assets from his creditors.⁵⁸ A Pennsylvania court held that an insured's repayment of a loan on a life insurance policy two weeks prior to bankruptcy is not in fraud of creditors.⁵⁹ The court reasoned that the exemption statute granted an absolute exemption regardless of whether the bankrupt had a fraudulent intent. The sum involved was only \$1,000. If the court were to be consistent it would have to grant a complete exemption however large the amount paid in fraud of creditors might be. This result is unfortunate. A person who foresees insolvency may gather whatever non-exempt assets he can reach and purchase a single premium paid-up life insurance policy naming his wife as the beneficiary. Upon the termination of his financial duress, via a discharge in bankruptcy, he may convert the policy into cash by exercising the cash surrender option of the policy. Such conduct would seem clearly fraudulent, yet in Pennsylvania, Indiana, and those states exempting the cash surrender value the above transaction would not be a fraudulent conveyance.

If creditor protection is to be favored, the appropriate alternative would be strict adherence to fraudulent conveyance concepts developed and still applied in other areas of the law. Life insurance would be treated no differently from any other asset. There is nothing in those statutes that do not mention fraud or exempt the insured, his estate, or his personal representative to indicate that an exception to the law of fraudulent conveyances is intended. At one time an Ohio court made such an interpretation.⁶⁰ However desirable that interpretation might be, it has little chance of acceptance; life insurance has become one of the most privileged assets in the United States.⁶¹

One alternative serves the legitimate purpose of family protection and at the same time protects creditors. This alternative is a statute that:

57. See generally Cohen, *The Fraudulent Transfer of Life Insurance Policies*, 88 U. PA. L. REV. 771 (1940); 1 COLLIER, BANKRUPTCY § 6.03 (14th ed. 1940); 1 GLEN, FRAUDULENT CONVEYANCES AND PREFERENCES 317 (rev. ed. 1940).

58. MACLACHLAN, BANKRUPTCY § 161 (1956).

59. *In re Silansky*, 21 F. Supp. 41 (E.D. Pa. 1937).

60. *Child v. Graham*, 8 Ohio Dec. Reprint 294 (1882) (also printed in 7 WEEKLY CINN. LAW BULL. 43).

61. Riesenfeld, *supra* note 31, at 617.

(1) limits either the amount of premiums that may be expended per year or the amount of proceeds that are exempt,⁶² (2) enlarges the exempt beneficiary category to include the insured, his estate, and his personal representative, and (3) provides that the expenditure of any amount above the statutory limit by an insolvent insured is constructively fraudulent, entitling those injured to reach the proceeds, or that proportion of the proceeds attributable to premiums in excess of the designated premium limit. This alternative permits recovery in both the premiums paid during insolvency and fraudulent transfer situations when the statutory limit is exceeded.

In effect, the statutory limit designates a reasonable amount of life insurance that may not be reached by creditors, and when combined with the enlarged beneficiary category precludes any question of a fraudulent conveyance below the statutory limit. Debtors as well as creditors benefit from this alternative, since the family is assured of receiving all the proceeds up to the statutory limit. Under the present Indiana position when there is a fraudulent transfer the defrauded creditor can reach the premiums paid during insolvency. If the fraud has continued for an extended period, the proceeds available to the family upon the death of the insured can be reduced from an adequate level to one below a minimum subsistence. This would be especially true when the face value of the policy was barely adequate initially. With a statutory limit these marginal families are more fully protected.

The principal objection to a statutory monetary limit is that it quickly becomes outdated because the purchasing value of the dollar is constantly decreasing. This result can be mitigated by the insertion in the statute of a cost of living factor or similar economic indicator that would adequately relate the value of the dollar in any future period to the value of the dollar when the statute was enacted.⁶³ The product of the designated statutory limitation and the economic indicator would equal the amount of the exemption in any subsequent period.

This suggested alternative would relieve the creditor of the burden of proving actual fraudulent intent. The proof of actual intent is very

62. A \$500 statutory limit on premiums has been adopted in three states: CAL. CIV. PROC. CODE § 690.19; MO. ANN. STAT. § 376.560 (1949); MONT. REV. CODE ANN. § 93-5814(7) (1947). Five states have adopted a limit on the amount of the proceeds that are exempt: COLO. REV. STAT. ANN. § 77-2-2(m) (1963) (\$5000 limit); IOWA CODE ANN. § 511.37 (1949) (\$15,000 limit); MISS. CODE ANN. § 308 (1942) (\$10,000 limit); S.C. CODE ANN. § 37-169 (1962) (\$25,000 limit); S.D. CODE § 31.1509 (1939) (\$5,000 limit).

63. There are various indices which may be appropriate: among them are the United States Bureau of Labor Statistics Index of average for the year wholesale prices and its Consumer Price Index.

difficult which, perhaps, explains why Indiana has had no recent litigation in this area.⁶⁴ How does one prove actual intent? One writer suggests that there are two methods: either by an admission of the insured or by a substantial accumulation of circumstantial evidence from which such intent may be inferred.⁶⁵ It seems very unlikely that an insured would openly admit that his design was to place his assets beyond the reach of creditors. By substituting a presumption of constructive fraud for proof of actual fraudulent intent where the deceased purchases, pays the premiums on, or transfers life insurance during insolvency, the statutory limit reduces the amount of circumstantial evidence needed to prove intent to a single event and thus makes it easier for creditors to recover. Although the Indiana fraudulent conveyance statute requires proof in fact of actual intent, an express intent requirement in the suggested exemption statute would take preference over it.

CONCLUSION

The Indiana Life Insurance Proceeds Exemption Statute denies a creditor any recovery when the alleged fraud consists of a payment of premiums during insolvency and permits a recovery only of premiums paid during insolvency when there is a fraudulent transfer. This statute thus emphasizes family protection to the virtual exclusion of other policy considerations. By ignoring these other considerations the exemption statute has created opportunities for abuse. After adequate family protection has been provided, it is very difficult to justify the payment of policy proceeds in excess of the adequate protection level to the family when the deceased is a debtor, but it is impossible to justify when the deceased has acted in fraud of his creditors. A new statute is needed to prevent such abuse.

64. Another reason is the limited recovery, there being little motivation to reach the premiums paid during insolvency when that amount is small.

65. Cohen, *supra* note 57, at 804.