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**TOPIC:** Lack of Named Beneficiary Leads to Loss of Death Proceeds in Bankruptcy

**CITES:** [In Re: Byrne](#), No. 14–35927(MBK) (U.S. Bkrptcy Ct. D. NJ, Nov. 13, 2015); 11 U.S.C. Section 522(d)(11)(C); [11 U.S.C. § 541\(a\)\(1\)](#).

**SUMMARY:** Nicole Byrne filed a Chapter 7 bankruptcy petition in late 2014. In May 2015, prior to the bankruptcy case being closed, Nicole’s husband, who was not a party to the bankruptcy, died. The deceased husband had \$105,000 of group term insurance on his life payable to his estate at the time of his death.

Nicole sought to have the life insurance proceeds exempted from her bankruptcy estate. The bankruptcy court decided that, if Nicole had been the *direct* beneficiary of her late husband’s life insurance, the proceeds would have been protected against the claims of her creditors. But since the *estate* was the beneficiary, the proceeds were *not* exempt, and thus they were available to satisfy Nicole’s creditors.

**RELEVANCE:** There have been so many recent *WRNewswire* articles reporting on flawed beneficiary designation cases that the AALU sponsored a webinar on those cases on December 15, 2015, that can be accessed at [\(AALU will insert link to webinar\)](#). Each case has its own lessons, but a recurring theme is that it is important for clients to

review and update beneficiary designations on a regular basis. The *Byrne* case also underscores the need for beneficiary designations to be crafted with care.

In this case, the record does not provide any background as to why Nicole's deceased spouse named his estate, rather than Nicole, the beneficiary of his group life policy (although it may have been the default beneficiary designation for the plan). It does seem likely that he would not have intended for the proceeds payable at his death to be dissipated as part of a bankruptcy process.

The insured's estate is often listed as the beneficiary of a life policy—either as primary or contingent. While there may be a good reason for naming an estate as beneficiary, all too often an estate becomes beneficiary as the result of not understanding the downsides, by default when no back-up beneficiaries are named and the primary beneficiary predeceases the insured, or because of neglect. For instance, an insurance company will insert the insured's estate as beneficiary if the policy owner or insured never named a primary or contingent beneficiary. The court in the *Byrne* case held that under bankruptcy law, the death proceeds available to the insured's estate's heirs were also available to creditors of the decedent's heirs in bankruptcy.

We can help our clients avoid making their life policies' death benefits vulnerable to their heirs' creditors by naming intended recipients direct beneficiaries.

**FACTS:** On December 30, 2014, Nicole Byrne filed a voluntary Chapter 7 bankruptcy petition. Several months later, on April 28, 2015, the Trustee filed a No Distribution Report. Prior to the case closing, on May 9, 2015, Nicole's non-debtor spouse passed away, leaving behind a New Jersey group life insurance policy in the amount of approximately \$105,000, as well as a small pension balance.

In light of her potential interest in the life insurance policy and pension, Nicole filed papers with the bankruptcy court to seek exemptions for the life insurance policy and pension, to which the bankruptcy trustee objected.

Nicole's position was that her interest in her late husband's life policy was an exempt asset under federal bankruptcy law. The trustee argued that because Nicole was not a listed beneficiary of the life insurance policy or pension plan, any proceeds thereunder flowed directly to her late spouse's estate. Thus, Nicole's claim to any funds from his estate should be classified as an inheritance, which impacted her ability to claim her asserted exemptions.

The court analyzed the situation by first observing that under federal bankruptcy law, a debtor's bankruptcy estate generally includes assets that have been inherited within 180 days of the filing of a bankruptcy petition. It next turned to the question of whether Nicole had valid exemption claims under federal law—the set of exemptions she chose in her bankruptcy filing.

The court interpreted this excerpt of the federal bankruptcy exemption statute related to life insurance:

**§ 522 Exemptions.**

(d) The following property may be exempted under subsection (b)(2) of this section:

(11) The debtor's right to receive, or property that is traceable to—

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor ...

The court's decision hinged on its interpretation of the word **traceable**. It stated:

[A] debtor must either have a direct **contractual right to** such funds and is awaiting receipt, or **previously received** the applicable funds based on such right and thereafter converted the funds into another form of asset...[T]he life insurance policy or pension plan could very well be traced back to those policies, such tracing presumes that the [d]ebtor had a right to those proceeds to begin with. **As set forth above, the [d]ebtor does not hold such right.** (Emphasis added.)

The court further noted that - since Nicole had not yet actually *received* the life insurance proceeds—due to the fact the probate process was not yet finished—it was further evidence that the traceability element of the statute was not satisfied. Thus, the court determined that Nicole was not entitled to any life insurance exemption under 11 U.S.C. Section 522(d)(11)(C).

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