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From the Bankruptcy Courts

Benjamin Weintraub* and Alan N. Resnick**

SECURITY INTERESTS IN KEOGH PLANS

Many prudent people prepare for their retirement by contributing to a fund while they are still working. Among the popular types of retirement plans is the Keogh plan, also called an HR-10 plan. The Keogh plan allows a self-employed person to save and invest for retirement while enjoying certain tax benefits, including the sheltering of the income used to make contributions to the plan. However, the plan must meet certain requirements to enjoy these tax attributes. For example, the amounts contributed are limited, and premature withdrawals are subject to a 10 percent penalty. Each Keogh plan also provides that the beneficiary’s interest in the fund may not be assigned or alienated.

Many courts have focused on the fate of a Keogh plan when the self-employed beneficiary files a chapter 7 bankruptcy petition. The prevailing view is that Keogh plans are self-settled trusts that are included in the bankruptcy estate. The plan is exempt only to the extent that it may be exempt under the applicable exemption statutes. A different issue arises, however, when the beneficiary attempts to give a creditor a security interest in the Keogh plan prior to bankruptcy. Is a security interest in a Keogh plan effective?

In re Nix

The answer to this question is found in the opinion of the Court of Appeals for the Fifth Circuit in In re Nix. On September 17, 1982, Dr. John Nix borrowed $50,000 from the First National Bank and executed an agreement to secure the debt with a certain “Keogh Self-Security Account.” The funds invested in the Keogh plan had been used to purchase

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1 See, e.g., In re Goff, 706 F.2d 574 (5th Cir. 1983); see also Weintraub & Resnick, “From the Bankruptcy Courts: In re Goff—Keogh Plans and IRAs as Property of the Bankruptcy Estate,” 16 U.C.C.L.J. 264 (1984).

2 864 F.2d 1209 (5th Cir. 1989).
stock in an oil company; the custodian of the account was Merrill Lynch, Pierce, Fenner & Smith, Inc., stockbrokers.

Apparently, First National Bank had initially questioned its ability to create an enforceable security interest in a Keogh plan. The bank relied on an opinion letter from Dr. Nix's lawyer, which concluded that a lien on the Keogh account could be created under Texas law pursuant to Article 9 of the Uniform Commercial Code. First National informed Merrill Lynch of the security interest and also filed with the Secretary of State a financing statement describing the Keogh account as the collateral.

Later, two new promissory notes were issued to First National in the sum of $80,000 and $25,000, and the original $50,000 promissory note was released. Nix secured both of the new notes by again granting First National a security interest in the Keogh account. As the court commented, "There can be no doubt, therefore, that both Nix and the Bank intended the assets in the account to serve as collateral for loans from the bank to Nix." Subsequently, the balance of the Keogh fund was reduced to $30,797 when Nix withdrew some of the assets from the account.

After Nix defaulted on both notes, he and his wife filed a chapter 7 petition. At that time the amount owed to First National was $124,724.88, including principal and interest. First National asserted that it had a perfected security interest in the Keogh account and requested that the automatic stay be lifted so that it could foreclose. The trustee in bankruptcy, joined by Nix, opposed First National's request "on the grounds that the Keogh account is a bank account rather than an intangible asset, and that the transactions between the bank and Nix did not suffice to create a valid, perfected lien."

The court of appeals succinctly summarized the issue: "The issue is whether a Keogh retirement plan, created to comply with federal tax law, is an intangible upon which a security lien may be created pursuant to Article 9 of the Uniform Commercial Code." Before tackling the issue on the merits, the court of appeals was quick to note that the case reached that court by an "unusual route." The issue was argued before a magistrate and not the bankruptcy court, since the district court had withdrawn from this case and others pursuant to 28 U.S.C. § 157(d) and then referred the case to a magistrate.

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3 Section numbers of the Texas version of the Uniform Commercial Code vary from the section numbers of the official version of the UCC. For the convenience of the readers, references to Code sections in this article are to the official version.
4 864 F.2d at 1210.
5 Id.
6 Id.
Although it approved the reference “because of a compelling need” to expedite bankruptcy cases, the court stated that a reference to a magistrate of a bankruptcy case should only be effectuated for an expediency of this nature.7

Turning now to the merits of the proceeding, the court of appeals had no doubt that funds in a debtor's Keogh account are property of the bankruptcy estate and ordinarily pass to the trustee even if the trust document creating the Keogh plan contains language prohibiting assignment or alienation.8 A clause providing restrictions on alienation is void as against the beneficiary's creditors. “The issue, therefore, is solely whether the assets in Nix's Keogh plan are subject to the lien asserted by the bank.”9

Rights in Keogh Plans as General Intangibles

The court focused on Section 9-201 of the Code and pointed out that the section makes security agreements effective according to their terms if they comply with the provisions of Article 9. As to general intangibles that “may be subject to security agreements, [they] are defined broadly in § 9-

7 Id. at 1211.
8 Id. at 1211.
9 864 F.2d at 1211.

10 Id.
11 Id.
tion, credit union or like organization, other than an account evidenced by a certificate of deposit.”

The court of appeals refused to recognize a Keogh account as simply a savings account for self-employed persons in anticipation of retirement. The distinction between Keogh plans and deposit accounts was explained by the court:

As the separate treatment of certificates of deposit in [Section 9-105 of the UCC] suggests, the phrase “savings account . . . maintained with a bank . . . or like organization” refers to accounts from which the depositor may withdraw funds at any time, subject only to such notice agreements as the bank may require. In contrast, a Keogh plan must be established in accordance with the provisions of the Internal Revenue Service, and is subject to the penalty tax that discourages regular withdrawals: Whereas bank accounts are funded solely with cash, a Keogh plan may be, as Nix’s was, funded in whole or in part with stock. Moreover, Merrill Lynch is not “a bank” or “like organization,” but a stockbroker. It therefore could not accept deposits under Texas Law. It held Nix’s Keogh plan assets as a fiduciary for him, not simply as a bank receiving a deposit. 13

The court concluded, therefore, that a Keogh plan is not a “deposit account” under Section 9-105 and that it is a “general intangible” that may be the subject of an Article 9 security interest. The court reversed the magistrate’s holding that no valid lien could be placed on Nix’s Keogh account, but since the magistrate concluded that First National had not properly perfected its lien and his conclusion “depended crucially on the premise that a valid lien on a Keogh account could not be created,” 14 the case was remanded for further proceedings.

Conclusion

Although the bank took the initiative in seeking relief from the automatic stay to foreclose on its lien in the Keogh account, nevertheless, absent such initiative Merrill Lynch as custodian would have been obligated to “deliver to the trustee any property of the debtor held by or transferred to such custodian.” 15 Of course, in that event, the custodian most likely would interplead the bank, the trustee, and the debtor in order to relieve itself from any responsibility. The result, however, would not change the outcome.

Although the court of appeals noted the fact that the custodian of the Keogh account in Nix was a stockbroker and not a bank, it appears that the court’s decision

12 U.C.C. § 9-105(l)(e).
13 864 F.2d at 1212.
14 Id.
would have been the same if the funds contributed to the Keogh plan had been deposited with a bank. In such situations the bank is acting as a trustee and fiduciary subject to restrictions, and there still would be tax penalties on early withdrawal. In essence, the bank holding a Keogh account is acting in a capacity that is "not simply as a bank receiving a deposit." 16

Some debtors may take comfort in the fact that Section 522(b) of the Bankruptcy Code protects property that is exempt and that certain states have created exemptions for Keogh plans so as to put such retirement savings out of the reach of creditors. 17 Nevertheless, self-employed persons should learn the lesson of Nix: Debtors may be effectively waiving exemption protection when they voluntarily give a lender a security interest in a Keogh account. 18

16 864 F.2d at 1212.

17 For example, New York exemption laws protect Keogh plans. See N.Y. Civ. Prac. L. & R. § 5205(c)(2) (McKinney 1989). Most states have opted out of the federal exemption alternative provided in §§ 522(b)(1) and 522(d) of the Bankruptcy Code, and in such states, exemptions are determined by state law.