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FROZEN OUT: A REVIEW OF BANK TREATMENT OF SOCIAL SECURITY BENEFITS

HEARING

BEFORE THE

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UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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FROZEN OUT: A REVIEW OF BANK TREATMENT OF SOCIAL SECURITY BENEFITS

THURSDAY, SEPTEMBER 20, 2007

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:06 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Salazar and Grassley.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

The book of Leviticus teaches, "You must not cheat your neighbor or rob him. You must not keep a hired worker's salary all night until morning."

Our hearing today will look at a modern application to this ancient rule. We will examine the case where banks are keeping Social Security beneficiaries' payments far longer than "all night," far longer than "until morning."

The Social Security law sets forth a rule much like that in Leviticus. The Social Security law says, "None of the monies paid under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal purposes."

In other words, Social Security benefits are protected. No one can garnish your Social Security check. That goes for Social Security benefits deposited electronically in bank accounts. Those benefits are protected, too.

But here is what is happening. A creditor alleges that a Social Security beneficiary owes the creditor money. The creditor goes to court. Sometimes the beneficiary really owes the debt, sometimes the beneficiary does not. But it is not always easy for old or disabled people to get to court to fight the creditor.

State courts routinely issue orders allowing creditors to freeze assets prior to garnishing funds to repay the alleged debt. The creditor then sends the court order to every bank in the State. The order instructs the bank to freeze some or all of the beneficiary's bank deposits as a first step towards garnishing the funds at a later date.

Generally, banks will not give the beneficiary a chance to prove that the funds in the bank account are from Social Security or another protected benefit, so the bank freezes the money. To make

matters worse, the bank will often charge the beneficiary an extra fee for the privilege of freezing the beneficiary's money.

As a result, these beneficiaries cannot get their Social Security benefits out of their accounts. These beneficiaries are often retirees or individuals with disabilities who need every penny of each month's benefit, and these freezes and fees have devastating results.

Many Social Security beneficiaries rely on their Social Security benefits to pay for their basic needs. Social Security is the only source of income for 1 out of 5 people over age 65, and, for two-thirds of people over age 65, Social Security is more than half of their income.

The same thing is happening to recipients of Supplemental Security Income, or SSI. SSI is a means-tested program, therefore, all of its beneficiaries are poor. They cannot afford to have any of their benefits taken away. The same thing is happening to recipients of Railroad Retirement benefits and veterans' benefits. The recipients of these benefits rely principally on these benefits, and they cannot afford to lose them.

For beneficiaries to unfreeze funds in the account, they must go to court. They usually need a lawyer. They have to prove that the funds in the account are from one of the protected programs. They have to get an order from the court to the bank to unfreeze the money, and they have to take that order to the bank.

Accomplishing all these tasks can be very difficult. These tasks take time. These tasks can prove all too much for many elderly or disabled beneficiaries. To make matters worse, once the funds are frozen, the bank often starts charging fees to the beneficiaries and the bank takes the fees right out of the beneficiary's account.

Banks often charge a $100 or $150 fee for having the account frozen and, once frozen, checks start bouncing. Banks charge $25 or $35 for every check or debit received while the account is frozen. Fees like that can add up. Even when the beneficiary gets the account unfrozen, the beneficiary will still have lost a significant portion of the Social Security benefits to the fees the bank charged.

I am not singling out any bank or financial institution for criticism. My concern about the banking system lies broadly across the system. Five banking regulatory agencies regulate banks. These agencies have been working together to come up with a common guidance for their banks regarding freezes of Federal benefits.

I had high hopes for this effort, but I was disappointed yesterday with the draft guidance that they released for public comment. The fundamental question is, do banks have to follow court orders to freeze Social Security and other benefits, even though Federal law says that garnishment of such funds is not permitted?

The answer should be a resounding "no." They do not have to follow those State court orders. But the answer in the guidance is, essentially, in many cases—most cases—go ahead and freeze the accounts.

The Supremacy Clause of the Constitution dictates that Federal law trumps State law, trumps State courts. Even if a State court wants a bank to freeze Social Security or other protected funds, the bank should not do so because Federal law bans such garnish-

ments. That is what the guidance from the banking regulators should have said.

I am going to explore this issue with several of our witnesses, and I hope that the five agencies will change this guidance to recognize that the Federal law protecting Social Security benefits controls.

Banks must stop freezing the benefits of people who have limited resources. Banks must stop charging fees as a result of these freezes. Banks must stop depriving our neighbors of the Social Security and other benefits that they have earned.

Before I turn to Senator Grassley, I want to acknowledge the help of Senator McCaskill from the State of Missouri. She has been working with the Aging Committee leadership on this issue. She and her staff helped us in many ways to prepare for today's hearing, and I very much compliment and thank Senator McCaskill, who would very much like to be here, but could not make it.

Senator Grassley?

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you very much.

Obviously with a large share of our seniors not having income from anything but Social Security, this hearing brings up a problem that is very important that needs to be solved once and for all, and we probably thought it was solved when these words were written a long time ago: "None of the monies paid or payable under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, except by express reference to this section."

There are similar protections applying to other Federal programs, including SSI, Civil Service retirement, Railroad Retirement, veterans' benefits. These protections are designed to prevent debt collectors from depriving beneficiaries of subsistence funds necessary for daily living expenses.

Despite these protections, creditors are able to secure State court judgments against Social Security beneficiaries in an effort to collect debts. In response to these judgments, financial institutions place freezes on accounts.

State law requires, generally, the notification of account holders who are subject to a freeze and provides them an opportunity to seek redress. However, pending a successful court challenge, it is obvious beneficiaries are denied access to their funds, resulting in this financial hardship.

The purpose of today's hearing is to examine how the protections afforded under my quoted section of the code are being undermined by current banking and legal procedures, and to determine what steps can be taken to address the problem. Specifically, the committee will seek to ascertain whether it is possible to avoid placing a freeze on protected Federal benefits, thereby avoiding harm rather than seeking to remove the freeze after the damages have already been done.

And, Mr. Chairman, if I could state orally a question that I would ask the witnesses if I could stay here, and ask them to ei-

ther answer in writing or by voice for the record today, is that all right?

The CHAIRMAN. Absolutely.

Senator GRASSLEY. This question would be for the FDIC, OTS, and OCC, but I would also like to have Ms. Saunders's thoughts on it as well. In your written testimony and before the committee this morning, you say this is a complicated issue, but, if you break it down into the essential parts, I do not think it would be all that difficult to resolve.

First, everyone agrees that certain Federal benefits are protected from certain creditors. Second, everyone agrees that once a beneficiary has established his benefits are protected, banks are obligated to protect them. This is complicated only by the fact that sometimes protected benefits are commingled with other funds.

However, as Ms. Saunders highlights in her testimony that I have had a chance to look at, there are several methods to address the problem. So, given the fact that banks can, and do, protect benefits after the beneficiary seeks redress through the courts, the question is the same: can the same protections be provided before a freeze is implemented and harm is done?

Some testimony suggests that, in order to accomplish this result, Congress or the Social Security Administration must clarify section 207. However, section 207 states that benefits shall not be "subject" to garnishment. But a freeze is nothing more than a means by which benefits are "subject" to garnishment. It should not be necessary to wait until benefits are frozen in order to protect them.

And, Mr. Chairman, if you need me, I will be right down the hall at Judiciary. Thank you.

The CHAIRMAN. Thank you, Senator, very much.

Our first witness is Waverly Taliaferro, a consumer whose accounts were frozen, even though the account held only his Social Security benefits. Then we have Ms. Sara Kelsey, who is the General Counsel for the Federal Deposit Insurance Corporation. Following her, Montrice Yakimov, who is the Managing Director of Compliance and Consumer Protection from the Office of Thrift Supervision in the Department of the Treasury. Following her, Ms. Julie Williams. She is the First Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of the Currency, also under the Department of the Treasury. Finally, Margot Saunders, who is counsel for the National Consumer Law Center and a nationally recognized expert on these issues.

Thank you all for coming. All of your statements will be automatically included in the record, but I would ask each of you please, in your oral testimony, to restrict your remarks to 5 minutes.

Mr. Taliaferro?

STATEMENT OF WAVERLY TALIAFERRO, SOCIAL SECURITY BENEFICIARY, NEW YORK, NY

Mr. TALIAFERRO. Thank you, Mr. Chairman.

Mr. Chairman and members of the Senate Finance Committee, thank you for having me today to speak to you. My name is Waverly Taliaferro. I am 70 years old. I was born and raised in Virginia.

I served in the U.S. Army at the White Sands Proving Grounds in New Mexico as a cinematographer. After leaving the Army, I married my wife, Millie, and continued to work in the film industry until I retired.

Since retiring in 2001, my only income is Social Security. It is now $1,508 a month. I have no nest egg. While my wife Millie recently started to work, her wages are not great.

Like others, Millie and I got credit cards while working. We always thought we could pay for them. However, life sometimes throws you a curve ball. In 2003, Millie lost her job. After paying rent, we had only $600 a month for food, medicine, utilities, and other necessities. Consequently, Millie could not pay her credit card bill.

On August 14, 2006, the credit card debt caught up with us. Our Citibank account was frozen. Millie was not working. The account had only $47 in it, all of which was left over from our direct-deposit Social Security from July.

I learned of the freeze when my August check was electronically deposited into the frozen account. Millie, through persistence and luck, found a free lawyer. Our lawyer gathered papers from Citibank and faxed a letter to the creditor. Our lawyer thought the account would be opened in a week.

Of course, bills were coming due: ConEdison, cable, phone, the rent. While we had family in Virginia, Millie and I thought we could, and should, weather this on our own. Eleven days after the account was frozen, the creditor wanted more information before it would release the account.

On day 15, the creditor added a new condition. Millie had to work out a payment plan before it would release the account. Since Millie had no income, this meant my Social Security. After our lawyer threatened to sue them, the creditor unfroze the account on day 23 of the freeze. I then discovered that Citibank had taken $45 for processing the restraint. While it was not a huge amount of money, it seemed like Citibank owed me an apology, not a bank fee. Although my lawyer asked the bank to return the fee, it never did.

Getting by on no money for 23 days was quite difficult. We ate all of our staples, spent the silver dollars I saved as keepsakes, and then survived off of a 10-pound bag of brown rice. Eating brown rice 3 times a day, Sunday through Saturday, is pretty tedious. Amazingly, neither Millie nor I got sick. Rather, we lost weight. I lost 40 pounds, Millie lost 3 dress sizes.

During those 23 days, we got used to being hungry. We got used to having no entertainment other than walking to the library or reading a book. We got used to the creditor's delay tactics. But what we could not, and have not, gotten used to was the fear that this dehumanizing experience could happen again.

One morning, we could find ourselves eating rice, scrounging for loose change in the sofa. Since August of 2006, I have gotten Social Security checks in the mail. To cash it, I have to go to the CD Check Cashing store on 9th Avenue. That is New York City, of course.

It is slightly unnerving. A lot of unhappy poor people are loitering and waiting in line. I pay $23 to cash my check. Millie worries that somebody will mug me. What upsets me is my loss of dig-

nity. I worked all my life. I earned my Social Security. Each time I enter the check cashing store I feel like a cheat or someone on welfare.

In March of 2007, my lawyer called with good news. Chase Bank would not restrain a bank account that contained only direct-deposit Social Security. I even got a $100 signing bonus when I told them I wanted direct deposit. I felt great. Sixteen days later, my Chase account was frozen. I immediately went to Social Security, but was too late.

A few days later, my March check sailed electronically into the frozen account. My lawyer explained that Chase was legally correct in restraining the account, as it contained $25 in leftover money from the $100 signing bonus. Luckily, Millie was working this time, and we could eat. Getting the Chase account released took a month. I lost money in bank fees as well.

Millie and I are good people. We have worked all of our lives. We are exploring options for dealing with our debts. Until then, we need a safe place to deposit my check.

When I was in the New Mexico Proving Grounds 50 years ago, I saw the government use its energy and intellect to create powerful weapons to keep us safe. Senator, please apply the same energy and intellect to this simple problem. Thank you.

[The prepared statement of Mr. Taliaferro appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Taliaferro. I deeply appreciate your testimony, and I regret the experience you have had to go through. Thank you very much for taking the time to come here.

Ms. Kelsey?

STATEMENT OF SARA KELSEY, GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, DC

Ms. KELSEY. Chairman Baucus, Ranking Member Grassley, and members of the committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation about garnishment of federally protected payments.

These payments are important and are often the sole source of income for many Americans. The FDIC is committed to achieving a solution to the garnishment issue. We are currently working hard at the FDIC to promote economic inclusion in the banking system.

The adverse publicity and concerns about garnishment, as we heard today, can undercut the attractiveness of an insured bank as a place for people to utilize financial services such as checking and savings accounts and direct deposit. The resolution of this issue is important to the achievement of our broader efforts to encourage consumers to be economically empowered through the banking system.

It is clear that Congress intended that Social Security and other Federal benefits not be garnished except in certain specific circumstances. However, the garnishment process is primarily controlled by State law, as you have observed. In that process, a State garnishment order is served on a bank, requiring that funds to a customer can be frozen while the process sorts out who is entitled to the money.

Freezing these funds is what harms the recipients of Federal benefits the most. It cuts off their principal, if not exclusive, source of income, and this can have, as we have heard, severe consequences. Beneficiaries may be unable to pay their monthly bills, and they may be subject to a variety of, as we have heard, bank fees and penalties for overdrafts and returned checks. These fees and penalties can be substantial and can cause additional hardship.

Even when the garnishment is properly resolved, the beneficiaries' accounts may be significantly depleted by fees and penalties. My written statement provides additional detail about the garnishment process and the relationship between State and Federal law. Let me focus this morning on a few key points.

First, State garnishment laws generally put the burden on benefit recipients to claim exemptions; however, benefit recipients often do not understand their rights under the Federal garnishment exemption, nor that they must mount a legal defense during the garnishment process.

Second, even if they are aware of available exemptions, existing garnishment procedures often provide inadequate protection for benefit recipients. State laws put the burden on the beneficiaries to defend themselves against the garnishment order. This defense is much more difficult for beneficiaries when access to their money is cut off by a freeze order.

Third, the Federal benefit agencies such as Social Security and the Veterans Administration interpret the garnishment prohibition as a defense to be asserted by a beneficiary after a freeze has been placed on their funds, not as a bar to a bank freeze of their accounts. In addition, court decisions interpreting the Federal prohibition are conflicting.

Finally, without a Federal rule preempting State garnishment orders, banks would be at significant legal risk if they refused to comply with State orders. Achieving a comprehensive solution that is needed to resolve these issues will require the active participation of a number of parties, including several not represented at today's hearing.

To that end, let me make two suggestions. First, Congress could directly address the situation by amending existing protections in the Social Security Act and other laws. Such legislation could spell out the extent to which such protections extend to freezes, as well as garnishment, and whether they operate as a bar to bank freezes or merely as a defense to be raised by benefit recipients.

Explicit language could preempt State laws or processes that operate contrary to this requirement. Legislation also could specifically address the fees and penalties currently associated with frozen accounts.

In the absence of legislative action, another option would be for agencies like the Social Security Administration and the Veterans Administration to issue regulations under their current statutory authority.

As the agencies responsible for these Federal benefit programs, they have the authority to set forth rules that detail how accounts and financial institutions that hold protected Federal benefit payments should be treated if an attempt is made to freeze the funds.

The FDIC and other banking regulators would then be able to enforce these interpretations of law under our general enforcement authority.

In conclusion, a comprehensive solution to the issues is important for beneficiaries and will require the participation of many parties. The FDIC is committed to finding a solution and willing to work with Congress and our colleagues at other agencies to achieve that goal. The guidance that the banking regulators issued for public comment yesterday is only a first step to help craft a workable approach to this issue and should provide us with useful information going forward.

This concludes my testimony. I would be happy to answer any questions that the committee might have.

The CHAIRMAN. Thanks, Ms. Kelsey, very much.

[The prepared statement of Ms. Kelsey appears in the appendix.]

The CHAIRMAN. Ms. Yakimov?

STATEMENT OF MONTRICE GODARD YAKIMOV, MANAGING DIRECTOR OF COMPLIANCE AND CONSUMER PROTECTION, OFFICE OF THRIFT SUPERVISION, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Ms. YAKIMOV. Thank you. Chairman Baucus, Ranking Member Grassley, and members of the committee, my name is Montrice Godard Yakimov, and I am the Managing Director of Compliance and Consumer Protection at the Office of Thrift Supervision, or OTS.

Thank you for the opportunity to present the views of the OTS on issues related to financial institutions' treatment of garnishment of Federal benefits.

Today's hearing highlights several complex issues: the intersection of Federal law with State laws and court procedures; the role and responsibilities of depository institutions that receive court orders to freeze accounts that may contain protected benefit payments; and the role of Federal bank regulators and other Federal agencies that administer benefit payments.

In my statement, I will address these challenging issues, describe the interagency guidance on garnishments recently released by the Federal banking agencies, and I will discuss the OTS's Advanced Notice of Proposed Rulemaking on unfair and deceptive acts and practices, through which we hope to collect substantive and instructive public comment on practices addressed by today's hearing.

Federal benefits, including Social Security, Supplemental Security Income, veterans benefits, Federal Civil Service retirement, and Federal Railroad Retirement benefits often constitute an important part, and sometimes all, of an individual's income. Social Security recipients are the largest group to receive government payments. Currently, over 54 million beneficiaries receive Social Security, Supplemental Security Income, or both. Nine out of 10 individuals aged 65 and older receive Social Security benefits, which represents 41 percent of their total income.

Federal law currently provides that such benefits are exempt from garnishment, apart from limited exceptions. However, State court garnishment orders often provide that financial institutions

are liable for funds withdrawn by a customer after the institution has received a garnishment order, and Federal laws that protect Federal benefits do not specifically prohibit an institution from freezing an individual's account during the period when a garnishment order is challenged by the recipient of the Federal benefits. As a result, financial institutions receiving these orders often place holds on the account while the matter can be resolved.

In order to raise awareness of this important issue and promote best practices, we have worked closely with the other Federal banking agencies to draft interagency guidance. The guidance advises depository institutions that best practices include promptly determining, as feasible, that the account contains only exempt Federal benefit funds; notifying the creditor, collection agent, or relevant State court that the account contains exempt funds; avoiding placement of a freeze on an account that contains only exempt funds if State law or the court order will permit it; minimizing the cost to a consumer when an account containing exempt funds is frozen and allowing consumers access to a portion of their account equal to the documented amount of exempt Federal benefits when an institution determines that the funds are not subject to garnishment under the court order; and, of course, lifting the freeze as soon as possible.

It is important to note that the proposed best practices are a significant first step in addressing the numerous issues presented with garnishments of protected Federal benefit payments.

Another important initiative that we are pursuing is an ANPR on unfair or deceptive acts or practices. The ANPR solicits comment on a wide variety of acts or practices that OTS could consider prohibited under section 5 of the FTC Act. These include issues relating to the practice of freezing accounts upon receipt of court orders to garnish.

We plan to share comments on this subject, and others we receive in connection with the ANPR, with the other banking agencies toward the goal of achieving interagency consistency on these issues.

In closing, the OTS strongly supports continued discussion by the appropriate Federal agencies and clear guidance by agencies that administer protected Federal benefits on interpreting statutes that preclude garnishments, levies, and attachments.

It may also be appropriate to consider legislation to provide financial institutions with protections from liability for failing to comply with a State court order if an institution acts responsibly when trying to maximize access to federally protected funds for its customers.

Please be assured that Director Reich and OTS stand ready to discuss challenges, address questions, and identify other steps that policymakers and regulators can take to better ensure that consumers who receive protected payments obtain the full benefit of protections provided by Federal law.

Thank you, Mr. Chairman, Ranking Member Grassley, members of the committee, for the opportunity to present the views of the OTS. I look forward to your questions.

The CHAIRMAN. Thank you, Ms. Yakimov, very much.

[The prepared statement of Ms. Yakimov appears in the appendix.]

The CHAIRMAN. Ms. Williams?

STATEMENT OF JULIE L. WILLIAMS, FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Ms. WILLIAMS. Thank you, Chairman Baucus. My name is Julie Williams, and I am the Chief Counsel and First Senior Deputy Comptroller of the Office of the Comptroller of the Currency.

Today's hearing highlights the hardships faced by recipients of Social Security, Veterans, and other Federal benefits when they are unable to access funds in their deposit accounts to meet their day-to-day living expenses because the account has been frozen in response to a garnishment order.

The fundamentals of the problem are these: various Federal laws exempt Federal benefits payments from garnishment, but these laws do not exempt financial institutions from State judicial processes and court orders that require a freeze or hold to be placed on funds in an account while the claim of the creditor, and the account holder's defenses to that claim, are resolved, pursuant to State law procedures.

Thus, even if funds in the account ultimately are established to be Federal benefits payments that are exempt from garnishment, until that occurs, the account holder loses access to some or all of the funds in the account for a period of time. Obviously, for individuals who rely on these benefits for essential living expenses, this is a significant hardship.

My written statement covers four points. First, we completely agree that there is a problem here that needs to be addressed.

Second, this problem is complex. The issues presented include unclear and undefined provisions of Federal law, State laws and judicial processes that may unintentionally produce results that conflict with Federal public policy objectives, and questionable practices by debt collectors. These issues also implicate important Federal policy objectives concerning how Federal benefit payments are paid.

Third, there are certain things that the Federal banking agencies can do, and we will do, to help. I will summarize those initiatives in a moment. But the actions that we can take are not a complete solution.

Finally, obtaining a comprehensive resolution of these issues will require coordinated action by multiple parties on multiple fronts. It could well require Congress to enact legislation to clarify intersections of Federal and State law unless agencies such as the Social Security Administration and the Department of Veterans Affairs conclude that, under the statutes they administer, current law provides them sufficient authority to provide definitive answers to key issues in this area. We defer to those agencies to advise the committee on whether or not they have sufficient authority to address these concerns under existing law.

As I said, there are actions the OCC and the other Federal banking agencies can, and will, take consistent with our respective regu-

latory and supervisory authority to alleviate some of the hardships associated with the process of garnishment of protected Federal benefit funds. One step we can take is to provide supervisory guidance to our regulated institutions concerning these matters.

Yesterday the OCC and the other Federal banking agencies issued for comment proposed guidance on practices by depository institutions relating to the garnishment process as it affects accounts containing Federal benefits payments. The proposed guidance reflects, and it seeks comment on, many of the same concerns contained in the questions posed in the committee's letter of invitation.

Specifically, in order for institutions to minimize the hardship to Federal benefits recipients and comply with State garnishment orders, the proposed guidance advises institutions to have policies and procedures in place to expedite notice to the customer of the garnishment process and the release of customer funds as quickly as possible. The proposed guidance also recommends a number of particular best practices that the agencies have seen among the institutions that we supervise.

The OCC is also taking steps to provide customers of national banks with more information to help understand what their rights, protections, and obligations are with respect to Federal benefits payments and the garnishment process. We will be posting this information to *www.helpwithmybank.gov,* the financial consumer website sponsored by the OCC, in the very near future.

In conclusion, Mr. Chairman, and as I summarized at the outset, we recognize that there is a very real and important problem here. The Federal banking agencies are addressing aspects of that issue that are within our respective authorities, but a comprehensive resolution will require involvement by other key Federal agencies, and ultimately Congress may have to act. We stand ready and willing to participate in this effort. Thank you. I would be pleased to answer your questions.

The CHAIRMAN. Thank you very much.

[The prepared statement of Ms. Williams appears in the appendix.]

The CHAIRMAN. Ms. Saunders?

STATEMENT OF MARGOT SAUNDERS, COUNSEL, NATIONAL CONSUMER LAW CENTER, WASHINGTON, DC

Ms. SAUNDERS. Chairman Baucus, Senator Grassley, members of the committee, thank you very much for inviting the National Consumer Law Center to testify here today.

One of my most important functions, I think, is to try to illustrate for you the breadth and depth of this problem. As you can see from the number of organizations—both national and State organizations—that have signed on to our testimony, this has become the most alarming issue legal services programs deal with on a daily basis, after predatory lending.

In the appendices attached to my testimony, there are summaries of dozens of cases from across the country in which we have tried to illustrate the personal damage that has occurred when Social Security and other Federal benefits have been attached.

Because of the EFT '99 (for "Electronic Funds Transfer"), many millions of low-income recipients of Federal benefits now have their payments directly deposited into bank accounts where they had previously received paper checks and had been completely protected from these garnishment activities. Yet, now we estimate that, on a monthly basis, thousands of low-income recipients of Social Security, SSI, and other Federal payments whose benefits are entirely exempt from claims of judgment creditors are left temporarily destitute when banks allow the attachments and the garnishments.

I would like to walk you through what exactly happens when an account is frozen under State law. First of all, as you know, no money is available to cover expenses for food, rent, or medical care.

Checks and debits previously drawn on the account, before the recipient learned that the account was frozen, are returned unpaid. Subsequent monthly deposits into the account will also be subject to the freeze, and also inaccessible to the recipient. The funds will remain frozen for a time period determined by State law before being turned over to the creditor.

In order to unfreeze the account, the recipient must find an attorney or go to the local courthouse on their own, fill out a form stating that the funds in the account are exempt, present the form and the accompanying proof to the court. If the creditor voluntarily agrees to release the funds, the creditor will send a release to the bank. At this point, it may still take several days, or even weeks, before the bank releases the funds.

But the creditor, under State law, does not have to release the funds upon receiving this proof from the consumer. The creditor can, and often does, request a hearing. When this occurs, the consumer almost always needs a lawyer. Lawyers are hard to find. Transportation to the courthouse, multiple trips to the courthouse, are difficult and expensive for people who are, by definition, elderly or disabled and often already impoverished.

The effect of the freezing of the exempt funds is, thus, a full taking of these funds for thousands of these recipients because rarely does the recipient have the wherewithal to pursue the process of claiming the exemptions.

The cases in this area have not yet caught up to the new reality and the technology. We have one case, the *Mayers v. New York Community Bancorp* case in New York, in which the court has recognized that, because of the electronic deposit of funds, the banks can now clearly see which funds are exempt.

Because of the new technology and the reality of so many more recipients being subject to attachment, this Federal district court is at least willing to entertain the idea that the traditional way of balancing the competing interests between the creditors and debtors may be switched, and that banks may have a constitutional requirement to look into the accounts before they freeze funds pursuant to an order for attachment or garnishment.

We may win the *Mayers* case, and we may win other cases across the country. The reason we came to Congress is that we are hoping that we do not have to take 10 or 15 years to litigate this throughout the courts of the country while thousands and thousands of

low-income recipients suffer the continued effects from attachment of their exempt funds.

The Proposed Guidance issued yesterday by the Federal regulators, I am afraid, does not appear to require much that is new. It looks like it is really only a reiteration of what some banks are already doing. We had hoped, and still hope, that the Federal regulators, those who regulate this Nation's banks, would take leadership on this issue, recognize that it is up to them to resolve the difference between Federal and State law and articulate that Federal law should be followed, even when it might conflict with State law.

So far as we know, the Supremacy Clause still rules, and the Federal law has always been found to preempt inconsistent State laws. We do not quite understand the hesitation of so many of these regulators to preempt State law. These regulators have preempted State laws regulating predatory mortgage lending, electronic deposits, and foreclosure protections. Why is there suddenly a fear of preempting State law here?

I am happy to answer any questions.

[The prepared statement of Ms. Saunders appears in the appendix.]

The CHAIRMAN. Thank you, Ms. Saunders.

What do you suggest the Congress do? The regulators say they are working on it. As I am reading between the lines, listening to the music as the three of you have testified, I sense you are looking for a little more guidance that results in greater protection of beneficiaries; whether the guidance is from SSA or from whomever, that is what you are looking for. I do not know whether you are looking for congressional action or not.

But let me ask you again, Ms. Saunders, what do you recommend here? Does Congress have to act and say there is a bar? Should we wait for the financial regulatory agencies to issue stronger guidance? I do not know whether they have the power, frankly—you can answer that question too—to supersede State law, or whether it takes an act of Congress. I do not know.

But I am going to ask, what do you recommend be done here to protect beneficiaries?

Ms. SAUNDERS. Senator Baucus, if one of the results of today's hearing would be an acknowledgement that the regulators do not have the power to supersede State law and that were to apply across all State laws, I would say overall that would be a net benefit for consumers considering the vast amount of consumer protection State laws that these very regulators have preempted. But on this particular question, I must answer that I do not see that congressional action should be necessary. The statute is as clear as it could be. It says: "No funds paid or payable are subject to attachment or garnishment."

The CHAIRMAN. I will go down the line here. Ms. Kelsey, that is what the statute says. It is a Federal statute.

Ms. KELSEY. The State process that results in the freeze is not the same thing as garnishment. We are not hearing that there is a problem in terms of banks turning over Social Security money to creditors. The problem is in the freeze. What we would like to see is either regulatory or statutory change. It is true that State laws can be preempted by Federal laws, but the agencies that have the

authority to interpret the law here are not the banking agencies, they are the benefit agencies who in fact have been treating the provisions as if they are a defense to the borrower, to the account holder, not as if they are a bar.

The CHAIRMAN. The question is, do you have to wait for the beneficiary agencies? Ms. Saunders, I will ask you, is it your view that this Federal law is so clear that we do not have to wait for the guidance from the beneficiary agencies? Is that true or not true, in your view?

Ms. SAUNDERS. Senator Baucus, the Federal regulators of the banking agencies regulate the activities of the banks.

The CHAIRMAN. Right.

Ms. SAUNDERS. And the distinction between a freeze and an attachment is hard for me to discern. The freeze is the first step of an attachment and would not occur but for the attachment order. So if money is exempt under Federal law, it is exempt from a freeze.

The CHAIRMAN. Right. So Ms. Williams, what about that?

Ms. WILLIAMS. Mr. Chairman, I agree with the basics that Ms. Kelsey has described. The Federal law here is the Social Security Act. The Social Security Administration has not interpreted that statute to work in the way that Ms. Saunders is suggesting. We have asked. The law is just simply not currently read by the responsible agency to say what is being suggested.

The CHAIRMAN. Have you asked the agency?

Ms. WILLIAMS. Yes, we have.

The CHAIRMAN. What do they say?

Ms. WILLIAMS. They say what Ms. Kelsey has said.

The CHAIRMAN. Which is?

Ms. WILLIAMS. That the protection that the statute provides is an affirmative defense that is available to be asserted by the benefit recipient in the State court processes that have been described.

The CHAIRMAN. Have you asked whether, in their view, it is a bar, an absolute bar?

Ms. WILLIAMS. They have told us that they have not addressed, and they have not yet taken the position, that the Social Security Act prevents or precludes the application of the State judicial processes to the banks. So our fundamental problem here is we have a statute that is not a statute that we administer or interpret.

The CHAIRMAN. But the statute is a statute. It is a Federal law. I can repeat what the law says. I mean, even though, in a sense, you do administer it because you are a financial regulatory agency, you are dealing with banks here.

Ms. WILLIAMS. We will absolutely apply it the way that it has been construed by the agency, by the department.

The CHAIRMAN. Do you feel you have the power to interpret this law differently? Do you have the power to say, wait a minute. I misread the statute here. My gosh. These accounts cannot be garnished. There is no way in the world they can be hindered. Do you have that power to make that determination?

Ms. WILLIAMS. We do not think we do, and particularly in the face of contrary interpretations by the Social Security Administration.

The CHAIRMAN. What is your view, Ms. Yakimov?

Ms. YAKIMOV. Senator Baucus, I would note that I think it is a positive step that the Social Security Administration, I believe, is going to be part of a dialogue where this issue about the interpretation of the SSA, the Veterans Administration, is a bar to an institution placing a hold on an account. I think both agencies, SSA and VA, are coming to the table to have the dialogue about their view, along with the agencies. That is a positive step and additional clarity can come out of that.

The CHAIRMAN. Ms. Saunders, again, I am looking for guidance from you. As you heard Ms. Williams say, she feels her agency does not have the power to issue regulations along the lines that you are suggesting.

Ms. SAUNDERS. I understand that the Social Security Administration may have said that the protection is only a defense. But the courts, including the Supreme Court, have consistently said that the exemption applies from before the time the money is payable to after it is deposited in the bank account. The Supreme Court has specifically made this rule applicable to veterans' benefits and to Social Security benefits, and numerous courts that are cited in the voluminous end notes to my testimony have also said that repeatedly. So that is not a hard or new issue.

The CHAIRMAN. What about that, Ms. Williams? What about those decisions Ms. Saunders is referring to?

Ms. WILLIAMS. Those decisions do not deal with the key issue here of the freeze and the position that the financial institution is put in where they are subject to State judicial freeze or hold processes.

The CHAIRMAN. Ms. Saunders?

Ms. SAUNDERS. That is true. There are only a few cases that deal with the freeze. The cases I was referring to deal with the ultimate question of whether the money is subject to attachment. But the point is that the cases say the money is exempt from attachment. All of these cases—all but a few, frankly—were decided before it was so easy for the banks to identify which money was exempt. We now have a very different technological situation where we have millions of people who have their money electronically deposited.

The bank can see with a touch of a button which money is exempt and which is not. That is a different situation which requires a different answer, a different response. It also requires a different response if the regulators and this government want to continue encouraging electronic deposit. Something needs to happen to protect these electronic deposits from these freezes.

The CHAIRMAN. Do any of these decisions deal directly with the freeze?

Ms. SAUNDERS. Yes, sir. There have been a few decisions—all in the Second Circuit so far as I understand—one that was back in the 1980s that held that the banks did not have to look into the account before freezing funds. But that was before this technological change. One, the *Huggins* case, I believe, held more recently that the banks did not have to look. Most recently, the *Mayers* case has come down from the Federal District Court in New York that says that banks may have to look. It recognizes the change in times and the new technologies.

But my point is, we should not have to litigate this in circuit after circuit. The regulators can themselves recognize the new technologies and take leadership here. These are not hard questions, except that it may be hard politically, because the banks do not want to look. The banks are making a lot of money off of these freezes.

In multiple States where the advocates have tried very hard to change the State law or State practice so that there would not be any conflict, the banks have rebuffed them. The banks have successfully turned back an effort where State law would have been clear in Virginia. They successfully did the same in Maryland. They are trying in New York. In Pennsylvania recently, the advocates had a success. We should not have to fight this issue State by State where we have the banks on the opposite side saying, no, we do not want to look. This is why the regulators should take leadership on this issue.

The CHAIRMAN. What about that? Are the banks talking to any of you, the regulators, about this issue? I will start with Ms. Kelsey. Have banks communicated their views about this issue to any of your agencies?

Ms. KELSEY. Do you mind if I answer the last question?

The CHAIRMAN. If you also answer the other question.

Ms. KELSEY. All right. Deal. All right. First of all, I agree with Ms. Saunders that it would be very unfortunate for the beneficiaries of these benefits if we end up with State-by-State litigation or State-by-State laws. There are some States that recognize that the freeze is the problem. California has a State law which provides that a minimum amount of dollars in the account cannot be frozen when an attachment order is sent to a bank. With a rule like this, recipients would always be assured that some exempt money would be available for necessities. They would thus be spared the hardship that Mr. Taliaferro faced. So there are solutions.

But we believe that beneficiaries should not have to wait for a State-by-State solution. We believe they need a Federal solution. There are some State court cases, including in the Second Circuit with the *McCauley* case, that indicate that the courts allow the State process to trump the Federal exemption. These courts have found that the due process rights of the benefit recipients are not damaged by this freeze. Regardless of these State court decisions, too many people are having severe problems with these freezes that must be addressed.

The CHAIRMAN. The other question?

Ms. KELSEY. All right. We have heard from the banks that they would be very happy also to have clarity and have this issue resolved. As Ms. Saunders has said, there is a lot of litigation going on and everybody would like clarity.

The CHAIRMAN. But Ms. Saunders is suggesting—I do not want to put words in her mouth—that banks are also suggesting some solution that benefits them as opposed to the beneficiaries. After all, that is the American way.

Ms. KELSEY. I think that the beneficiaries are customers of the banks and that it is in the best interest of the customers and the banks to have clarity in the law. What our guidance amounts to

is trying to get the banks more involved in getting the freeze lifted, but we believe it would be far better if the freeze could not happen in the first place.

The CHAIRMAN. And what is the best way to prevent the freeze from happening in the first place?

Ms. KELSEY. Either through regulations issued by the benefit agencies or by Federal law.

The CHAIRMAN. I am a little unclear on this. Again, Ms. Saunders, why do you think it is not necessary for the benefit agencies to weigh in here?

Ms. SAUNDERS. I think it would be fine for the benefit agencies to weigh in. However, it seems to me that this is an interpretation of bank practice and that the Federal regulators of banking have the authority to address this issue. They are simply choosing not to use this authority because their constituents do not really want them to use it.

The CHAIRMAN. Cutting through the court cases, forgetting all that, what is the right public policy here? What is right? Irrespective of whether it is the benefit agencies that need to weigh in or whether it is the financial agencies' actions, or Congress, or whatnot, what is the right answer here?

Ms. KELSEY. I think Congress already has addressed its public policy.

The CHAIRMAN. Again, what do you think the right answer is?

Ms. KELSEY. I think Congress wants the beneficiaries of Federal benefits to be protected.

The CHAIRMAN. And that there be no freeze.

Ms. KELSEY. I think the problem is that the devil has been in the details here. We would like to get those details——

The CHAIRMAN. And I am asking you, what is right with respect to the details? What is the right policy here? If you were writing the right answer here, what would that answer be?

Ms. KELSEY. The FDIC would like to see the depositors protected.

The CHAIRMAN. In all respects?

Ms. KELSEY. In all respects.

The CHAIRMAN. And there be a complete bar? That is, no State court law or agency in any way could freeze a beneficiary's checks?

Ms. KELSEY. I have trouble with absolute statements, but what I will pledge is that we are all willing to work——

The CHAIRMAN. I know you are willing to work. That is not my question. My question is, what is the right policy? Ms. Kelsey, irrespective of your agency, you are an American citizen. What is the right thing to do here?

Ms. KELSEY. Well, I think that my views are not different from my agency's.

The CHAIRMAN. And again, the views are?

Ms. KELSEY. That the depositor should have access to their funds.

The CHAIRMAN. And not an absolute, virtually absolute bar. Is that is what is right here?

Ms. KELSEY. There is actually an exception in the Social Security Act to certain types of things.

The CHAIRMAN. Like child support.

Ms. KELSEY. Yes.

The CHAIRMAN. All right. Child support. What else?

Ms. KELSEY. Alimony.

The CHAIRMAN. Alimony. What else besides those two? Any exceptions you think are good public policy?

Ms. KELSEY. I believe those are the two that I am aware of.

The CHAIRMAN. Taxes? All right.

Let me ask Ms. Yakimov the same question. What is the right thing to do here?

Ms. YAKIMOV. Senator Baucus——

The CHAIRMAN. What is right? There is Mr. Taliaferro sitting next to you, the people depending on this. Their banks, their creditors, all that. What is right here?

Ms. YAKIMOV. The right thing to do is to protect Federal benefits to the full extent that is possible under the law. I think it would be a great help if State court orders were clear about——

The CHAIRMAN. I am not asking what the law is or is not. I am asking you what is right with respect to Social Security benefits. Forget states, forget the law, forget everything. What is the right thing to do here? What is right with respect to Social Security recipients' benefits in a bank? Should they be frozen, not frozen?

Ms. YAKIMOV. I think the challenge—no. The public policy about protecting Federal benefits is sound policy. It is something that I think each of us supports. The question is how to achieve it, how to ensure it, how to make sure it is implemented.

The CHAIRMAN. Why not just tell banks, sorry, you cannot freeze Social Security benefits?

Ms. YAKIMOV. Right. Some of the challenges that I think institutions face is when accounts are commingled, where there are two people on the account. These are the details we are trying to work through.

The CHAIRMAN. I understand that. Ms. Saunders talked about electronic deposits. These days that usually can be determined quite easily, those commingling questions.

Ms. YAKIMOV. Clarity on these issues for institutions so that they can comply with the Federal law on these protections—that is the right result.

The CHAIRMAN. Do not forget, though, we are not talking just about financial institutions, we are talking about somebody's Social Security benefits.

Ms. YAKIMOV. Absolutely.

The CHAIRMAN. So we are not only worried about—you are talking about clarity for the banks. What about what is right for the beneficiaries?

Ms. YAKIMOV. Clarity for the banks for the purpose of protecting consumers who are relying on these benefit payments.

The CHAIRMAN. All right.

Ms. Williams, you have had a long time to think about this now. [Laughter.]

Ms. WILLIAMS. Mr. Chairman, I think there are two things that need to happen. There needs to be clarity so that some or all of the funds in the account are not frozen. I say "some" because there are models under State law that set a dollar amount, they say you can-

not freeze a certain amount in an account, you cannot garnish, you cannot freeze.

The CHAIRMAN. Well, wait a minute. I thought the Federal statute says all these benefits are protected.

Ms. WILLIAMS. That would preclude a freeze being put on. So prevent a freeze for some or all of the amounts in an account while a garnishment process is taking place.

Second, clarify what the financial institution is expected to do, exactly what inquiry you want the institution to undertake, to look back for 60 days, 90 days, to ascertain whether there are exclusively Social Security funds coming into the account. Do you want the financial institution to be tracing funds, trying to figure out funds in the account, and, if it is commingled, how much is protected benefits?

So there are two things: to protect from the freeze aspect of a garnishment process some or all of the funds in the account, and then, second, to make very clear what the expectations are of the financial institution and their inquiry into the nature of the funds in the account, those two things.

The CHAIRMAN. You say "some or all." I am a little bit confused there. Why some? Why not all?

Ms. WILLIAMS. Well, again, an approach that has been employed in California that Ms. Kelsey referred to, is a certain dollar amount in an account is just simply not subject to garnishment, so you would never get into the issue of whether you freeze that amount in connection with the garnishment process that we have been describing.

The CHAIRMAN. That is California. I am not asking about California. But what is right? What about, none can be frozen?

Ms. WILLIAMS. That is the issue. I am just saying that the two things that need to be done are, to clarify whether a freeze applies to some or all of the funds in the account, and to clarify what the obligation of the financial institution is in checking as to the nature of the funds in the account.

The CHAIRMAN. All right. Now, with all due respect, you did not really answer my question. So I am going to go back and ask you, what is the right answer to each of the two questions you raised?

Ms. WILLIAMS. I think the right answer, first, is to clarify what the obligations of the institutions are. Sir, I do not know what the exact right answer is. There are some practices that we have identified in the proposed guidance where institutions look back for 60 or 90 days, and they can determine whether all of the funds that have gone into the account are coming from protected Federal benefit sources, and then they do not freeze the account.

The CHAIRMAN. What is the right answer to your first question?

Ms. WILLIAMS. You can, as a policy matter, decide that you want to protect everything in the account or some in the account.

The CHAIRMAN. You are not answering the question. What do you think the right answer to that question is?

Ms. WILLIAMS. I think the right answer, in part, may depend on feasibility. I think that we should be trying to find a way that protects, to the maximum extent that is practicable, the Federal benefits pays that are in the bank accounts of benefits recipients.

The CHAIRMAN. Well, Mr. Taliaferro, it is probably kind of interesting for you, sitting down there, to listen to all of this.

What thoughts do you have about all of this? Are they just kind of all wrapped up in regulations or kind of missing the whole point here, or do they maybe have a thing or two that is valid, maybe? You have been through a wrenching experience, a really wrenching experience. I am interested in your on-the-spot thoughts about some of this.

Mr. TALIAFERRO. It seems they are circling the wagons around the issue. I do not see any definitive results or answers.

The CHAIRMAN. I would agree with that. I think you are on the right track.

Ms. Saunders, your reaction to all this again? I will give you another shot.

Ms. SAUNDERS. Senator, we would like to see the regulators—these regulators—come out with a simple rule that says something along the lines that banks should not freeze accounts which contain electronically deposited funds, except to the extent certain exceptions are met. One exception might be if the State court order specifically identified the judgment as being for child support or alimony.

The other exception would be if the account includes commingled funds, in which case we would ask the Federal regulators to take a second step and come up with a uniform rule—and there are several to choose from that have been discussed here today—by which the banks should determine which funds are exempt and which funds are not exempt when they have been commingled.

The last thing that we would want, and I think that the regulators or Congress would want, would be a rule that comes out that would encourage or discourage the use of these bank accounts for any other purpose. We do not want Social Security recipients to have second-class bank accounts. So, if they had protections from exemptions so long as they had no other funds in the accounts, but, if they added $1, the entire account would be subject to attachment, would be a very flawed response.

The CHAIRMAN. Ms. Kelsey, what do you think about that suggestion? Basically, with electronic accounts, I assume there is no freeze or attachment or anything, except for those exceptions that are under the law, like child support, alimony, and so forth, and where there is commingling, there are ways to deal with it. If I understand her, that is her basic point. Does that make sense?

Ms. KELSEY. I think that the mechanism, tying a bar to the electronic deposit, is a good one. But the benefit agencies should be the ones to say that is the bar, because they are the ones that possess the authority to say that.

The CHAIRMAN. Ms. Yakimov?

Ms. YAKIMOV. I think the benefit agencies have to be a part of the solution and we need them to come alongside us as we identify——

The CHAIRMAN. Apart from that, I am asking your opinion whether Ms. Saunders' suggestion is on the right track, is a good one.

Ms. YAKIMOV. I think it is a valid suggestion that we ought to take back and we ought to explore. I guess one thing I would add

is the issue about these State court orders that subject institutions to liability for failing to comply. I think that has to be——

The CHAIRMAN. I am sorry. I missed that. Say it again.

Ms. YAKIMOV. There are State laws, and in the State court order, failing to comply subjects the institution to some real risk, some liability. I think that has to be a part of this conversation. So if we were to come out with a rule that says you should not freeze except in these circumstances, that has to be part of the dialogue.

The CHAIRMAN. Right.

Ms. YAKIMOV. But I do not disagree with Ms. Saunders' suggestion. I think it is something we ought to take a look at. But again, the benefit agencies have to be a part of the discussion and part of the solution. The immunity, this liability issue, has to be part of it as well.

Ms. WILLIAMS. Mr. Chairman, I think this is an area that cries out for a clear, uniform solution, so I agree with what Ms. Saunders has said on that.

The CHAIRMAN. Does that sound like a good, uniform solution?

Ms. WILLIAMS. Some of the suggestions that she mentioned could be.

The CHAIRMAN. The basic ones she said. I asked her what makes sense.

Ms. WILLIAMS. I think where we disagree is how you get there.

The CHAIRMAN. And what is the disagreement on how you get there? She thinks you could do it on your own.

Ms. WILLIAMS. On our own. I think we are saying——

The CHAIRMAN. You think you cannot?

Ms. WILLIAMS. We think we need to look to the benefit agencies because they are the ones that administer and interpret the key statutes.

The CHAIRMAN. So if the benefit agency were to say, all right, financial regulators, this is what it is, it is a bar when it is electronically deposited, except for the exceptions. That is it. Will you follow that?

Ms. WILLIAMS. We would enforce that law.

The CHAIRMAN. You would enforce that.

Ms. WILLIAMS. Yes.

The CHAIRMAN. It would not be a law. It would not be a law. You would enforce that advice?

Ms. WILLIAMS. That is correct.

The CHAIRMAN. All right.

Would you, Ms. Yakimov, your agency?

Ms. YAKIMOV. I think that is right, yes.

The CHAIRMAN. Ms. Kelsey, would you?

Ms. KELSEY. Yes.

The CHAIRMAN. What do you think?

Ms. SAUNDERS. Great.

The CHAIRMAN. Great.

What do you think, Mr. Taliaferro?

Mr. TALIAFERRO. Yes.

The CHAIRMAN. All right. So in effect, we are waiting for SSA and the other benefit agencies.

Ms. SAUNDERS. Could I make one more comment, sir?

The CHAIRMAN. Yes.

Ms. SAUNDERS. We have asked all of our attorneys—and we have many, many list serves, so probably thousands of attorneys have been asked this across the country—if anybody has ever heard of a bank who has refused an attachment order or dissolved an attachment order because it only is applicable to exempt funds which has faced any potential legal liability, and nobody has ever heard of such a situation.

So this is a straw man that is being put in front, as an excuse for not going forward in this process. We think State law does not really interfere.

I would like to make two other points. One is that, at least in New York—and we have not looked in other States—it is clear that no contempt of court action can be maintained against a bank for the bank's refusal to attach exempt funds. Second, it is specifically a violation of State law, common law, unfair trade practice, and the Fair Debt Collection Practices Act, for creditors to knowingly pursue exempt funds. So for a creditor to attack a bank for refusing to freeze exempt funds would subject the creditor to legal liability for doing that. This is why it is so unlikely that banks would be subject to any legal risk for refusing to attach exempt funds.

The CHAIRMAN. There is one little problem here, as I see it. It is usually a problem in life when you are waiting on somebody else to do something that maybe you can do yourself. In this case, we are in some sense kind of waiting on the benefit agencies. The problem there is, they may not do what we are assuming they are going to do. Why might they not? Because their recommendations have to be cleared by the Office of Management and Budget.

The Office of Management and Budget notoriously restricts advice, the primary advice, that agencies have, or restricts actions that the agencies might want to take. You cannot call OMB before this committee. They do not go to anybody. It is just a very, very difficult—potentially very difficult—problem.

I say that because I do not know whether any actions you take might have to be cleared by OMB or not. My guess is that it is not the case, it does not have to be cleared by OMB. If it does not have to be cleared by OMB, the burden may fall on you to do what is right because the benefit agencies may not be able to say what is right because the Office of Management and Budget prevents them from saying what is right here. That is a real possibility and, in fact, a likely possibility, and almost a probability.

So I am going back to all of you. You may just have to do what is right on your own and not have to wait, because the benefit agencies may not be able to say what they think is right, because the Office of Management and Budget may not let them. This Congress runs across that continually, time and time again. It is a problem.

Ms. Kelsey?

Ms. KELSEY. If what you say is correct, doesn't that point to the need for congressional action?

The CHAIRMAN. Unless you, on your own, can stand up and issue the regulations because you are interpreting the statute, a Federal statute, under the Supremacy Clause of the Constitution, to prevail.

Ms. KELSEY. It is not our statute.

The CHAIRMAN. We are all Americans. It is a Federal statute. It is a Federal law. As I read the statute, it is basically that the benefits are protected.

Ms. KELSEY. The courts will look to the agency whose statute it is, as we did. We consulted them and we got their interpretation. If we were to come out with an interpretation of their law that is different from their interpretation, it would not fare well in the courts.

The CHAIRMAN. Ms. Saunders, your view of that? You may be right, Ms. Kelsey. I am interested in Ms. Saunders's reaction.

Ms. SAUNDERS. These agencies have regulatorily interpreted the application of State laws, such as unfair trade practice laws, foreclosure laws, many State laws that are not strictly within these agencies' purview to interpret. I have been practicing consumer law for several decades and have seen far too many instances where these agencies are interpreting laws that were written by other entities outside of Congress to apply to consumer protections, and yet those consumer protections are lifted by virtue of these agencies' interpretation.

So, frankly, when I tell my colleagues that this is the reaction on this situation, everybody laughs because there does not seem to have been any inhibition of these agencies to interpret State laws and other Federal laws that are not strictly under the National Banking Act for the Comptroller of the Currency, or the Homeowners' Loan Act for the Office of Thrift Supervision.

We are asking for an interpretation of banks' activities under another law. It is not the interpretation of the Social Security Act, it is the responsibility of how the banks should behave under this other law.

Ms. WILLIAMS. Mr. Chairman, if I could just clarify one point of the situations that Ms. Saunders referred to, because a number of them involve my agency. They involve interpretations of the National Bank Act and the intersection of the National Bank Act with various provisions of Federal law. It doesn't involve situations that are comparable to the one that we are grappling with here.

The CHAIRMAN. Ms. Saunders, I am just a little curious. I know you are initially reluctant to have Congress solve this, thinking the financial regulatory agencies can do it themselves. As I hear them, I do not have a lot of confidence that they are going to do a lot themselves. They should. It may require an act of Congress. Do you think Congress should step in now or not?

Ms. SAUNDERS. If necessary, I would hope Congress would step in. I am not sure that the law needs to be any clearer than it is, but if that is what it takes——

The CHAIRMAN. All right. Well, I do not know if we are going to get any further today at this point. It is my view that all of you, your agencies, should go the extra mile to protect beneficiaries. The law is pretty clear. Federal statute is pretty clear.

I know there are complexities in life, and there are other laws, and all this and that, and it always happens. But I just think sometimes it is right to just stand up and do what is right and find a way to interpret those other laws, those other regulations, those other agencies' views, those other State decisions, whatever they are, in a way that is consistent with primarily, if not totally, pro-

tecting beneficiaries. I just urge you to find a way. Find a way to do what is right.

Ms. YAKIMOV. Senator Baucus, I would add just two things. One is, the guidance that we issued is out for public comment. It gives us an opportunity to reflect on what we hear from consumer groups, consumers, and the industry and to go from there.

And the other point I would make is, we do have an ANPR that is out for public comment—public comment closes November 5—specifically around freezing accounts with public benefits, with Federal protected benefits. So I do not think this is the end of the conversation. I think is one of several.

There is the dialogue on an interagency basis, there is a potential ANPR which we hope will work with other agencies, there is the public comment on the guidance that we have issued. So I think the agencies are very, very willing to continue to look at these issues and to continue to work with you and others on identifying solutions.

The CHAIRMAN. All right. But there are two points here. Just keep remembering Mr. Taliaferro in, one, driving toward the right solution, and, two, doing it very quickly.

Thanks, everybody. Thanks for coming and testifying.

The hearing is adjourned.

[Whereupon, at 11:27 a.m., the hearing was concluded.]

A P P E N D I X

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

STATEMENT OF

SARA A. KELSEY
GENERAL COUNSEL
FEDERAL DEPOSIT INSURANCE CORPORATION

on

THE IMPACT OF GARNISHMENT
ON SOCIAL SECURITY BENEFITS

before the

COMMITTEE ON FINANCE
U.S. SENATE

September 20, 2007
215 Dirksen Senate Office Building

Chairman Baucus, Ranking Member Grassley, and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) concerning issues related to the garnishment of federally protected benefit payments. Federal benefit payments are an important -- and often the sole -- source of income for many Americans. Actions that limit access to these funds can result in hardship and expense for the benefit recipients. The FDIC is committed to ensuring that recipients of federal benefits receive the full protection of those benefits to which they are entitled.

The use of garnishment as a debt collection tool raises many issues when it is applied to accounts containing federal benefit payments. When institutions receive garnishment or attachment orders, they customarily freeze deposit accounts, even though such accounts hold the proceeds of benefit payments which generally are exempt by law from garnishment. Even when benefit recipients ultimately are able to successfully challenge the garnishment of their federal payments, they often suffer financially from the garnishment process because of the freezing of their accounts.

In my testimony, I will discuss legal protections applicable to federal benefit payments and the interplay between federal law and state civil procedures for garnishment and attachment to satisfy unpaid debts. In addition, I will describe actions the FDIC and the other federal banking agencies are taking to address the issues surrounding garnishment, as well as recommendations for achieving a comprehensive resolution.

Background

While garnishment procedures vary from state to state, funds in an account at a financial institution generally may not be seized without a court order. After receipt of the court order, pursuant to the requirements of state law, the financial institution must place a "hold" or "freeze" on the debtor's account. In many states, financial institutions are potentially liable for any funds withdrawn by a debtor from an account after a freeze or hold has been placed upon it pursuant to a court garnishment order.

As a result of a freeze or hold being placed upon an account, the debtor account holder is not able to withdraw money from the account or draw checks upon it. State garnishment laws usually provide that notice must be given to the debtor that an account has been frozen or had a hold placed upon it. Several jurisdictions require a formal hearing at which time the debtor is given an opportunity to explain why frozen funds should not be seized or garnished. It is at this juncture that debtors typically raise the defense that the funds that have been frozen are protected from garnishment by various exemptions.

Under federal law, several types of federal benefit payments are protected from garnishment or attachment by creditors. These include Social Security benefits, Supplemental Social Security benefits, Veterans Administration (VA) benefits, civil service retirement benefits, military retirement annuities, and railroad retirement benefits. While each type of benefit is protected under its own respective statute, these laws

typically provide that the benefits are not subject to execution, levy, attachment, garnishment, or other legal process.[1] In addition, state laws often provide for certain types of funds to be exempt from garnishment, such as private pension payments.

The interplay between state garnishment law and federal benefit exemptions is complex and raises a number of legal and practical issues. Court garnishment orders often tend to be broadly worded with no reference to exemptions under either federal or state law. Moreover, exemptions to garnishment may have their own exceptions. For example, while Social Security benefits generally may not be garnished, they may be garnished or attached pursuant to a valid court order to collect debts related to alimony or child support. This makes it difficult to determine whether funds in an account that otherwise would be exempt from garnishment under federal law should still have a hold or freeze placed upon them.

The intricate relationship between state and federal requirements with respect to garnishment of federal benefit funds is made even more problematic by state and federal case law that provides little guidance on how to handle such issues. For example, a Second Circuit court decision[2] upholds New York's civil procedure law requiring a freeze on all funds held in garnished accounts, including exempt federal benefits, finding that the beneficiaries' due process rights were not violated by this requirement because the statute provided beneficiaries with notice and an opportunity to prove that the funds were exempt. This holding is being questioned in ongoing litigation in a New York

[1] *See*, for example, section 207 of the Social Security Act, 42 U.S.C. § 407.
[2] *McCahey v. L.P. Investors*, 774 F.2d 543 (2d Cir., 1985)

federal district court. In the litigation, the district court judge is open to considering the claim that New York civil procedure violates the beneficiaries' rights to due process by not treating a federal exemption for benefit funds as a bar against placing a freeze or hold against the funds, even if imposed pursuant to a state court garnishment order.[3]

An additional complicating factor in the relationship between state garnishment procedures and Social Security benefits is the Social Security Administration's (SSA) interpretation of the garnishment exemption. The SSA recommends to beneficiaries that "[i]f a creditor tries to garnish your social security check, inform them that, unless one of the five exceptions apply, your benefits can not be garnished." In other words, the exemption provision is to be treated as a defense to be raised by a beneficiary after a freeze or hold has been placed on an account pursuant to a garnishment order, rather than a bar against the imposition of the freeze or hold in the first place. Veterans Administration staff have a similar interpretation of their counterpart provision exempting VA benefits from garnishment or attachment.

In the face of this uncertainty, many financial institutions conclude that the safest and most prudent course of action is to comply with the requirements of state garnishment orders and to leave it to the depositors to establish whether funds in their accounts are exempt from garnishment under federal law -- and wait for the state process and courts to determine entitlement to the funds. This is especially true in light of

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[3] *Mayers v. New York Community Bancorp, Inc.*, not reported in F.Supp.2d, 2005 WL 2105810 (E.D.N.Y.).

numerous decisions where the recipient of a court order has been held in contempt for not complying with the order even if it was subsequently found invalid.

Issues

The application of state and federal law regarding garnishment raises a number of issues for benefit recipients, banks and regulators.

Many benefit recipients are unaware of the exemption

State garnishment laws generally contemplate a process that places the burden on benefit recipients to claim applicable exemptions. However, benefit recipients are often unaware of the exemptions available to them. The court order may not make reference to any potential exemptions and the benefit recipient may have limited access to legal advice. Too often, benefit recipients do not understand their rights under the exemption or their need to raise a defense during the garnishment process. Clarification of these rights and responsibilities is clearly needed. To effectively provide benefit recipients with an opportunity to exercise their rights, information regarding possible exemptions should be provided contemporaneously with the notification of the garnishment order.

Current procedures provide inadequate protection for benefit recipients

Even if a benefit recipient is aware of available exemptions, existing garnishment procedures often provide inadequate protection for benefit recipients. State garnishment laws are generally designed to rely on a process that provides beneficiaries with notice and an opportunity to claim that some or all of their funds are exempt from a garnishment order after it is issued. However, beneficiaries can suffer financial hardship that results from losing access to the exempt funds during the garnishment process.

Freezing an account that may represent a beneficiary's principal, if not exclusive, source of income can have severe consequences. The recipient may be unable to perform essential financial functions, such as paying rent or making a mortgage payment. In addition, account holders may be subject to fees and penalties associated with the freeze, such as fees for placing a freeze on the account, overdraft fees, and penalties for returned items. These fees and penalties can be substantial and can cause additional hardship. Even when the garnishment is properly resolved, affected accounts may be significantly depleted by fees and penalties.

Garnishment orders are often overbroad

Many state court orders are overly broad and encompass all funds. These orders may specify that the financial institution is to protect all funds in the benefit recipient's account, even though the state statute recognizes particular exemptions including

federally protected benefit funds. In short, when an institution receives a garnishment or attachment order affecting deposit accounts, it faces difficult choices that implicate both its customers' interests and its own legal responsibilities. A bank runs a legal risk if it fails to take action under state creditor laws and/or court issued garnishment orders.

The application of garnishment exemptions to commingled funds is difficult

The accounts of many recipients of federal benefits do not solely contain funds from federally protected sources such as Social Security or VA benefits. Instead, such funds are mingled with funds from other, non-exempt sources such as private employment. Commingled exempt and non-exempt funds are essentially indistinguishable. It is difficult to trace such funds in an account and to determine their source of origination. Because of the difficulty in ascertaining whether funds in a garnished account are entitled to the protection of a federal exemption, it is often easiest for banks to freeze the entire account and have the court apportion the funds in the account between those that are exempt and those that are covered under the garnishment order.

FDIC Initiatives

The FDIC recognizes the important issues raised by the interaction of state and federal law with regard to garnishment and the impact the current situation has on recipients of federal benefits. Although the FDIC and other bank regulators currently

lack adequate legal authority to effectuate a comprehensive solution to the issues raised by garnishment, we are working to address these issues to the extent possible.

Initially, the FDIC is taking steps to increase public awareness of the exemptions from garnishment that are available to benefit recipients under federal law. For example, in October, the FDIC is participating in a workshop on debt collection hosted by the Federal Trade Commission. Attendees will consist of individuals interested in the debt collection process, including debt collectors, bankers, and consumer advocates. The FDIC will participate on a panel discussing current issues in debt collection, where we will explain the protections afforded certain federal benefit payments. We also will discuss the growing problems surrounding garnishment of these funds and efforts by federal banking agencies to develop guidance in this area.

In addition, the FDIC has hosted interagency meetings -- the most recent meeting including SSA and VA representatives -- for the primary purpose of addressing the issues surrounding garnishment of protected federal benefits at financial institutions. The interagency working group discussed the merits of various policy options, including issuing guidance on responding to garnishment orders. The FDIC is seeking to ensure that any guidance or statement it issues on the subject of garnishment provides consumers and banks with the most complete expression of legal authority on the subject possible. Such guidance should sensitize financial institutions to the issues regarding garnishment, seek their more active involvement in the resolution of garnishment orders, and generate public comment on possible solutions. At the same time, the FDIC recognizes that

guidance alone is an incomplete solution and cannot address many of the significant issues raised by garnishment of federal benefits without additional statutory or regulatory changes such as those we recommend below.

Finally, the FDIC also is in the process of studying overdraft protection programs, including how non-sufficient funds (NSF) fees are applied. Specifically, we are conducting a survey as to how banks handle NSF items and how customers make use of overdraft protection. While this study does not extend to the garnishment process itself, we hope that the information gathered through the study will provide useful information that will contribute to our understanding of how banks manage accounts that receive Social Security benefits. The study is expected to be completed in 2008.

Comprehensive Solutions

While there are steps the bank regulatory agencies can take to increase awareness and encourage certain best practices on the part of financial institutions in becoming more actively involved in the resolution of garnishment orders with respect to customer accounts containing federal benefits, achieving a comprehensive solution for the issues presented by garnishment will require the active participation of a number of parties not represented at today's hearing. The FDIC would suggest two alternatives to address these important issues.

One alternative would be for Congress to amend the Social Security Act and other counterpart federal statutory provisions to spell out in detail what protections are available for federal benefit payments. Such legislation could spell out the extent to which such protections extend to freezes as well as garnishment, and whether these protections operate as a bar to banks or merely a defense for benefit recipients.

In the case of the Social Security Act, Congress could amend section 207 to provide that the section operates as an absolute bar against the freezing, garnishment or attachment of Social Security payments, rather than as a defense to garnishment to be raised by an account holder after being denied access to the funds as the result of a hold or freeze. Explicit language could be inserted into section 207 that preempts any state law provision or process that operates contrary to this requirement. Congress could specify that the section 207 bar against garnishment extends to placing a hold or freeze on an account that contains only Social Security payments. Legislation also could specifically address the fees and penalties currently associated with accounts that are encumbered by a garnishment order or other legal process.

The issue of commingling of exempt and non-exempt funds could be addressed in a number of ways. A statutory provision could direct that all direct deposits of Social Security and other federal benefit payments must go into a separate account of the beneficiary with no commingling allowed of funds from other sources. Another possible solution could be to mandate that certain minimum amounts in such accounts could not be frozen, garnished, or attached so that subsistence funds would remain available to

account holders while their legal rights are being resolved. Similar amendments could be made to the law regarding VA benefits and other legally protected federal benefit payments.

In the absence of legislative action, another alternative to address this issue would be for agencies like SSA and VA to promulgate regulations under their current statutory authority. As the agencies responsible for implementation and interpretation of their benefit programs, they are in the best position to provide guidance on the garnishment exemption issue. At this time, there has been no formal rulemaking or interpretation by means of a statement of policy by SSA or VA on this issue, the issuance of which would provide bank regulators with legal authority to enforce such interpretations. If theses agencies were to provide interpretations of law, the FDIC and other banking regulators would then be able to enforce these interpretations under our general enforcement authority.

Conclusion

Congress intended that Social Security and other federal benefits not be subject to garnishment, except in certain specific cases. However, it is most frequently the freezing of funds that causes harm to recipients of federal benefits programs. Moreover, the garnishment process is primarily controlled by state law. As currently implemented, this process causes significant hardship for beneficiaries who lose access to their primary source of funds while they wait for a legal determination of their rights, and who are

assessed fees even if they demonstrate that their funds should be protected. Regardless of the outcome of the garnishment proceeding, these account holders suffer financial harm.

The FDIC is committed to achieving a solution of the garnishment issue. As many of you know, the FDIC is working hard to promote economic inclusion in the banking system. The adverse publicity and concerns about garnishment can undercut the attractiveness of an insured bank as a place for people to utilize financial services, such as checking, savings and direct deposit. The resolution of this issue is important to the achievement of our broader efforts to encourage consumers to be economically empowered through the banking system.

The FDIC will work with Congress and our colleagues at other agencies to achieve a solution that truly addresses these issues. This concludes my testimony. I would be happy to answer any questions that the Committee might have.

Response to Question posed by Senator Grassley
from Sara Kelsey, General Counsel
Federal Deposit Insurance Corporation

Question: In your testimony ... before the Committee this morning, you describe this as a complicated issue. But, if you break it down into the essential parts, I do not think it would be all that difficult to resolve. First, everyone agrees that certain federal benefits are protected for certain from creditors. Second, everyone agrees that once a beneficiary has established his benefits are protected, banks are obligated to protect them. This is complicated only by the fact that sometimes protected benefits are commingled with other funds. However, as Ms. Saunders highlights in her testimony ... there are several methods to address the problem. So given the fact that banks can and do protect benefits after the beneficiary seeks redress through the courts, the question is: can the same protections be provided before a freeze is implemented and harm is done? Some testimony suggests that in order to accomplish this result, Congress or the Social Security Administration must clarify section 207; however, section 207 states benefits shall not be "subject" to garnishment. But, a freeze is nothing more than the means by which benefits are "subject" to garnishment. It should not be necessary to wait until benefits are frozen in order to protect them.

It is clear that Congress intended that Social Security and other federal benefits not be garnished, except in certain specific circumstances. In the garnishment process, primarily controlled by state law, a state garnishment order is served on a bank requiring that funds in a customer account be frozen while the process sorts out who is entitled to the money. It is the freezing of the funds while a determination is made whether garnishment is appropriate that harms recipients of federal benefits the most. Cutting off this vital source of income can have severe consequences.

Resolving the issue is complicated by the interaction between federal and state law, as well as unsettled case law regarding garnishment. Numerous court decisions have held recipients of court orders in contempt for not complying with the order, even if the order was subsequently found invalid. Nevertheless, as a first step in addressing this issue, the FDIC and the other federal banking agencies have issued a statement for public comment that proposes best practices for financial institutions to protect consumers' funds while remaining in compliance with applicable laws and court orders governing garnishment, attachment, and other legal process. The best practices have been designed to actively involve banks so that issues relating to freezes can be quickly resolved and the account holders can be given access to their exempt benefit funds as soon as possible.

At the same time, the FDIC is continuing to explore additional options. For example, the FDIC is working with the Social Security Administration and the Veterans Administration to examine a regulatory solution by encouraging those agencies to issue a legal interpretation clarifying their interpretation of the statute. The FDIC and other banking regulators would then be able to enforce these interpretations of law under our general enforcement authority. We also are reviewing whether a statutory solution might be necessary to achieve a comprehensive solution to the issue. If we determine such a change is necessary, we will promptly notify the Committee.

As I testified, the Federal Deposit Insurance Corporation is currently working to promote economic inclusion in the banking system. Social Security and other government benefit payments are an important -- and often the sole -- source of income for many Americans. The adverse publicity and concerns about garnishment can undercut the attractiveness of an insured bank as a place for people to utilize financial services, such as checking, savings, and direct deposit. The resolution of this issue is important to the achievement of our broader efforts to encourage consumers to be economically empowered through the banking system.

STATEMENT OF
SENATOR KEN SALAZAR
FINANCE COMMITTEE HEARING
SEPTEMBER 20, 2007

Thank you, Chairman Baucus and Ranking Member Grassley, for holding this hearing. I would also like to welcome the witnesses who are joining us this morning.

This issue we are here to discuss today is particularly frustrating because our laws in this area seem pretty clear. Creditors are not supposed to be able to take away Social Security or disability payments from the Americans who count on them to meet basic expenses.

Yet all over the country, seniors and people with disabilities are finding out that the benefits they thought were protected are being taken out of their bank accounts almost as soon as they go in.

What's more, short of seeking legal aid, these beneficiaries are left with almost no recourse. The Social Security Administration says it's not responsible for protecting benefits once those benefits have reached the pockets of their recipients. Banks say they are not legally required to check whether accounts contain funds that should be exempt from creditors. Furthermore, they say that the ban on collecting debts out of Social Security doesn't apply to them when they charge fees for imposing freezes on accounts or for the bounced checks that inevitably result from such freezes.

In fact, according to a recent Wall Street Journal story on this issue that I know many of us are familiar with, Bank of America collected $284 million in overdraft-related fees from just over a million accounts in California that received direct deposits from Social Security.

Not surprisingly, some beneficiaries have resorted to opting out of the direct deposit option for receiving benefits. These people have decided that it's easier to receive a paper check, travel to a place that will cash it, pay a fee to do so, and pay for their expense with cash. This can't be the answer. Direct deposit was supposed to eliminate frustration, not cause it. We can't keep asking people to jump through hoops to keep benefits that shouldn't even be at risk of being taken away.

I think today's hearing offers an important opportunity to look at ways to repair this clearly flawed system. I am pleased that our five banking regulatory agencies announced yesterday that they intend to develop guidance that will encourage financial institutions to have policies and procedures in place when it comes to handling these types of federal benefits.

I hope that this hearing will offer some fruitful discussion of how we can better protect the millions of Americans who rely on these benefits, and I look forward to hearing from our witnesses.

Thank you.

Frozen Out: A Review of Bank Treatment of Social Security Benefits

Testimony before the

Committee on Finance
U.S. Senate

on behalf of the
Low Income Clients
of the
National Consumer Law Center
and
Consumers Union
Consumer Federation of America
National Association of Consumer Advocates
National Legal Aid & Defender Association
National Senior Citizens Law Center
National Veterans Legal Services Program
U. S. Public Interest Group

Community Justice Project of Pennsylvania
Jacksonville Area Legal Aid
Legal Advocacy Center of Central Florida
Legal Aid Society of Roanoke Valley
Legal Services of New Jersey
MFY Legal Services of New York City
Mississippi Center for Justice
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September 20, 2007

Frozen Out: A Review of Bank Treatment of Social Security Benefits

Committee on Finance
U.S. Senate

Chairman Baucus, Senator Grassley, Members of the Committee, thank you very much for inviting me to testify about the escalating problems caused by bank freezing of exempt funds. In the past few years this issue has become one of the most alarming and frequent reasons for emergency requests for assistance to legal services lawyers all over the nation. I am here today, testifying on behalf of not only the low income clients of the **National Consumer Law Center,**[1] but also the **Consumer Federation of America,**[2] **Consumers Union,**[3] **National Association of Consumer Advocates,**[4] **National Legal Aid and Defender Association,**[5] **National Senior Citizens Law Center,**[6] **National Veterans Legal Services Program,**[7] and the **U.S. Public Interest Research Group.**[8] In addition, the following local and state legal aid programs would like this testimony to speak for their low income clients: **Community Justice Project of Pennsylvania, Jacksonville Area Legal Aid, Legal Advocacy Center of Central Florida, Legal Aid Society of Roanoke Valley, Legal Services of New Jersey, MFY Legal Services of New York City, Mississippi Center for Justice, Mountain State Justice of West Virginia, Neighborhood Economic Development Advocacy Project, North Carolina Justice Center, and the Virginia Poverty Law Center.**[9]

Members of the Committee, as you know, in recent years the number of recipients of Social Security and other federal benefits who receive their payments electronically has risen dramatically.[10] This is undoubtedly the result of the huge government effort to promote direct deposit fostered by the passage of EFT 99 in 1996, which requires that all federal payment (except income tax refunds) be electronically deposited.[11] Both the law and Treasury's regulations implementing it recognize that electronic deposit may not be for everyone, and there are broad waivers allowing individual recipients to continue receiving paper checks.[12] Nevertheless, *many millions of low income recipients of federal benefits now have their payments directly deposited into bank accounts, where they had previously received paper checks.*

The federal government saves substantial money through direct deposit,[13] and direct deposit of federal benefits into a bank account is often advantageous to low-income recipients. The money is safe and accessible at the bank and through its network of ATMs. Payments are simplified because checks or electronic debits are available. High fees from check cashing stores and the need to purchase money orders are avoided.

However, there are two major and increasingly significant drawbacks to direct deposit: (1) the increase in bank accounts held by low income federal payment recipients has increased recipients' vulnerability to illegal and improper seizure of their exempt benefits, and (2) fees charged to customers with low-balance accounts are growing at exponential rates.

We estimate that on a monthly basis thousands of low income recipients of Social Security, SSI and other federal payments whose benefits are entirely exempt from claims of judgment creditors are left temporarily destitute when banks allow attachments and garnishments to freeze their only assets. As was illustrated in a recent Wall Street Journal article ("*The Debt Collector vs. The Widow – Viola Sue Kell thought her Social Security benefits were safe in the bank. She was wrong.*"),[14] when a bank applies an attachment or garnishment order to the exempt funds in a low income recipient's bank account, the consequences are generally devastating. There is no money for food or medicine. Checks written for rent or the mortgage are bounced. People go hungry. They get sick or sicker. They suffer anxiety. They are forced to pay steep bank fees and fees to merchants because the checks they wrote when they had money in the bank now bounce.

The banks say it is not their duty to determine which accounts contain exempt funds. They say it is not their job to refuse attachment orders issued by state courts just because the accounts contain exempt funds. The banks – and the OCC and the Federal Reserve Board – say that it is the business of the courts to sort out which funds are exempt from attachment and which funds are available.

We disagree with this assessment as a legal matter and as a policy matter. Legally, the cases have not yet caught up with the technological situation that exempt funds directly deposited in bank accounts presents, but the case law presents no bar to such a requirement. As a policy matter, how can there be any dispute that the funds provided by American taxpayers to keep this nation's elderly and disabled from starvation and destitution should be kept available rather than frozen for the convenience of creditors who have no right to the monies?

This dispute brings us to this hearing today. You have asked me to answer two questions:

1. When Social Security, SSI, Railroad retirement, and Veterans' benefits are electronically deposited in a beneficiary's bank account, and the bank receives a garnishment or attachment order from a state court on behalf of a creditor who is seeking to recover debts allegedly owed to the creditor by the beneficiary, should the bank be allowed to freeze the funds and/or garnish or attach them? Stated differently, should the bank first determine if the funds are from one of these Federal benefits, and refrain from freezing and/or attaching or garnishing the funds if the funds are from such benefits?

2. Should banks be able to charge fees against Social Security, SSI, Railroad Retirement, or Veterans' benefits funds electronically deposited in a bank account that have been frozen, attached or garnished as in item #1 above? Such fees include, but are not limited to, fees for implementing the freeze, attachment or garnishment, for restoring frozen funds, or for returning checks or debits because there are insufficient funds in the account resulting from the freeze, attachment or garnishment.

We have also provided our opinion on the question that you asked the agencies – whether they have authority to regulate in this area.

I. Financial institutions should be required to identify electronically deposited exempt funds and freeze only non-exempt funds when they receive attachment or garnishment orders.

Social Security benefits, SSI benefits, Veterans' benefits, Railroad Retirement benefits, were all intended by Congress to be used exclusively for the benefit of recipients to ensure a minimum subsistence income to workers and the disabled.[15] To preserve these benefits for recipients, Congress provided that the benefits cannot be seized to pay pre-existing debts, as such seizures would result in the loss of subsistence funds. Each of the statutes governing the distribution of these funds specifically articulates that these funds are to be free from "attachment or garnishment or other legal process."

The courts processing the competing interests of the creditors, debtors and banks have articulated the underlying reasons for these protections. The courts have enumerated the following purposes to exemption protections: (1) to provide the debtor with enough money to survive; (2) to protect the debtor's dignity; (3) to afford a means of financial rehabilitation; (4) to protect the family unit from impoverishment; and (5) to spread the burden of a debtor's support from society to his creditors.[16]

This nation's courts have consistently said that exemptions are to be liberally construed in favor of the debtor.[17] The United States Supreme Court has repeatedly reiterated that the Social Security,[18] and Veterans Benefits[19] are protected from attachment and garnishment. The protections in these federal statutes explicitly apply to benefits that are "paid and payable" thus making the benefits exempt both before and after payment to the beneficiary,[20] regardless whether the creditor is a state or a private entity.[21]

In *Porter v. Aetna Casualty and Surety Co.*,[22] the Supreme Court held that veterans disability benefits deposited in a bank account remained exempt so long as they are readily traceable and "retain the quality as moneys," that is, they are readily available for the day-to-day needs of the recipient and have not been converted into a "permanent investment."[23] This rationale has been widely applied to other exempt benefits, to hold that exempt funds remain exempt in checking,[24] savings,[25] or CD[26] accounts so long as these are "usual means of safekeeping" money used for daily living expenses.[27]

These rationales have also been routinely applied to Social Security benefits,[28] holding that those benefits are generally exempt from attachment by creditors when those benefits are deposited into a bank account as long as the funds are available on demand or for the support of the beneficiary and *even when they are commingled with other funds.*[29]

Despite the explicitness of the federal law and the purpose of these benefits, banks (after receiving garnishment or attachment orders) routinely freeze accounts holding these benefits.

When the account is frozen, no money is available to cover any expenses for food, rent, or medical care. Checks and debits previously drawn on the account (before the recipient learned that the account was frozen) are returned unpaid. Subsequent monthly deposits into the account will also be subject to the freeze and inaccessible to the recipient.

The funds will remain frozen for a time period determined by state law before being turned over to the creditor. In order to unfreeze the account, generally the recipient must find an attorney or go to the local court house on their own, fill out a form stating that the funds in the account are exempt, and then present the form and accompanying proof in the form of letters from Social Security and bank statements to the creditor. If the creditor voluntarily agrees to release the funds, the creditor will send a release of the attachment to the bank. At this point, it may still take several days or even weeks before the funds are actually released.

However, if the creditor does not voluntarily agree to release the funds, the only way to have the bank account unfrozen is for the recipient to request a hearing. In most cases a lawyer is necessary to help a recipient through this arcane judicial process. Yet lawyers are hard to find in many areas of the nation. Legal aid programs are often overwhelmed with other work. Transportation to lawyers, the courthouse and the bank is often difficult and expensive for recipients, who are by definition, elderly or disabled and often impoverished. *The effect of a freezing of exempt funds is thus – generally – a full taking of these funds, because rarely does the recipient have the wherewithal to pursue the process of claiming the exemptions.*

Commingling of exempt funds with non-exempt funds or funds of another does raise the problem of traceability. However, the majority rule across the United States is that exempt funds will continue to be protected even when deposited into accounts with non-exempt funds,[30] generally applying a first-in first-out accounting method.[31] A small minority of courts have refused to require tracing, finding that the exemption was lost when the funds were commingled.[32]

The Banks' Response

Although some banks do examine accounts to determine whether they are comprised exclusively of exempt funds[33]-- in which case, the bank declines the attachment order– the majority of banks do not. Upon receipt of a judgment creditor's request for attachment, most banks ignore even clear evidence of exempt funds – such as electronic deposit from the Social Security Administration – and simply freeze the recipient's bank account.

Because of two significant changes in recent years – 1) the huge influx of low income recipients who receive the federal payments through direct deposit and 2) the ease with which banks can now identify these exempt amounts in the accounts because of this electronic record – it is appropriate for the banks to respond differently in the future.

As was recognized by the federal district court in the recent case of *Mayers v. New York Cmty. Bancorp, Inc.,*[34] the traditional constitutional balancing between the competing interests of the players now dictates a different response by the banks. Some banks routinely look to see if the

account is comprised of solely exempt funds. Clearly, it is neither difficult, illegal, nor expensive to perform this analysis first. The issue is whether the banks *should* look, not whether they can – because they clearly can. The technology is simple – every electronic deposit is denominated by the source and type of funds.

The more complex issue is what should happen if the funds are commingled – either with non-exempt funds owned by the recipient, or with funds of another person who is not a debtor on the attachment or garnishment. Here it is very important that we do not create the incentive for Social Security and other beneficiaries to have second class bank accounts – as we would if by depositing one dollar of non-exempt funds the recipient would lose any protections applied to accounts comprised purely of exempt funds. It would seem to be a backwards national policy to punish the normal use of bank accounts by recipients when they deposit other funds in their accounts, when one of the stated reasons for EFT 99 was to encourage the use of mainstream banking by low income federal recipients.[35]

The use of a simple accounting system – as has been required by the courts as a matter of routine when there is commingling – could be easily adapted for the automatic use by banks for accounts with electronic deposit of exempt benefits. As is explained in the Montana Supreme Court case of *Dean v. Fred's Towing:*[36]

> We see no reason why the "tracing" of funds as used here to determine what amount in an account is attributable to exempt funds should not apply with equal force to exempt Social Security funds in an account ... if sums [are] exempt at their source they remain exempt even though commingled with non-exempt funds, as long as the exempt source of the funds [are] reasonably traceable.[37]

In the age of sophisticated computer technology, it would be so simple for this elementary accounting principle to be applied upon the press of a button to bank accounts containing exempt funds.

If the recipient is able to object to the attachment of the bank account containing exempt funds, this accounting analysis will have to be performed in any event – because that is the traditional way to determine which funds are exempt when they have been commingled. So the proposal here would be to have the nations' banks all use a simple accounting program, required by their regulators, which would simply be performed *before* the attachment, rather than after it.

If a simple accounting system is applied, we recommend it be the "First In Last Out" system. Under this system, exempt funds are considered to be the first deposited and the last withdrawn on any given day. Of course, exempt funds are deposited electronically only once or twice a month, so the system is simple to administer, especially with modern computers.[38]

An alternative system that would be simpler mathematically would be to adopt – on a uniform, national basis – the method that several states use to determine which funds are exempt

when there has been commingling in an account. For example, in California, a set amount is considered to be exempt from all attachments, and only the funds in the account which exceed that amount are available for attachment.[39] A simple system such as this provides certainty and ease of use for the banks, as well as basic protections for the recipients.

Liability to the banks exists only for *not* providing these protections to exempt funds

The banks, as well as several of the banking agencies, insist that this is a complicated question involving the intersection of state and federal law, and that banks run a legal risk for *not* freezing an account in response to a court ordered attachment or garnishment. We disagree with this assessment.

Every state law requires that attachment and garnishment orders apply only to non-exempt funds.[40] We believe it highly unlikely, if not impossible, that banks would be exposed to any legal jeopardy for refusing an attachment when the only funds the bank is refusing to attach are exempt under federal law.[41]

We have closely reviewed the exemption law in every state for the answer to the question of whether a bank might be under any legal jeopardy for refusing to attach funds that are clearly exempt under federal law. It appears to us that in every state except three[42] the recipient is required to attach only *non-exempt* funds.[43] In those three states, there may be some ambiguity because the *status* of the exemption appears to apply only after the debtor has asserted the exemption. However, it seems highly unlikely that upon review, any court would agree that the failure to follow a specific *state* procedure would mean that *federal* exemptions are lost.

In fact, such a result seems potentially a violation of the Supremacy Clause. State laws are preempted if they conflict with the purposes of a federal law or regulation. Moreover, as was explained previously, the courts throughout the nation have already articulated that exemption procedures are to be liberally construed applied so as to protect debtors.[44]

Indeed, we have never heard of any case in which a bank suffered even the burden of legal inquiry after it refused to honor an attachment or garnishment order because the only funds on deposit were exempt. In fact, this scenario seems highly unlikely, given the fact that creditors and their attorneys would pretty clearly face legal jeopardy of their own for pursuing funds that they have reason to know are exempt. In recent years, creditors and creditors' attorneys who wrongfully seized exempt funds in bank accounts have been found subject to common law claims such as conversion, negligence, or intentional infliction of emotional distress and to statutory claims for violations of the Fair Debt Collection Practices Act and state unfair and deceptive practices statutes.[45]

On the other hand, our advocates report numerous cases in which the banks were required to pay the recipients money because the bank *failed to look* or ignored clear evidence of the exempt status and applied attachment or garnishment orders to exempt funds, or refused to release funds when the bank customer brought proof of that exempt status.[46]

Finally, if banks and other financial institutions followed guidance issued by their federal regulators regarding how to treat federally exempt funds, it seems highly improbable that any state court would hold the bank liable for not applying an attachment order to federally exempt funds.

II. Fees charged Social Security recipients and others should be very limited.

The banks assess expensive fees against these frozen accounts. Although the account is frozen and inaccessible to the depositor, the bank still deducts its fees from the balance. The act of freezing the account itself generates an "attachment fee" deducted from the account – generally between $100 and $150. All checks, ATM withdrawals, and preauthorized electronic transfers for rent and other purposes are returned for insufficient funds. Every time a debit request is returned unsatisfied, the bank NSF fee – generally in the amount of $25 to $35 – is deducted.[47]

These fees can eat up the precious money in an account all too quickly, and should be strictly limited, if not prohibited. Certainly they should not be a profit center for the bank.

In the appendix to this testimony there is a story of a low income recipient of Social Security from New York whose *entire account* -- consisting of a bit over $800 in Social Security funds, plus about $100 in money given to her by relatives to help her through the month – was soaked up by bank fees in less than two months time. The bank charged an attachment fee ($125), plus numerous overdraft fees on checks written prior to the attachment and preauthorized electronic debits that the recipient could not stop without paying the bank stop payment fees. These fees were all collected by the bank from mostly Social Security funds, after an attachment order was applied. Neither the recipient, nor the creditor received any of the funds, just the bank that held them.

If overdraft fees and other fees are permitted to be charged against federally exempt funds in bank accounts, at the least they should be limited to the actual cost of the expense that generated the fee. It makes no sense as a policy matter for the American taxpayer to be expending millions of dollars on a yearly basis to help recipients avoid destitution, only for substantial portions of these funds to be siphoned off by the banks that are distributing their funds.

III. The Federal banking agencies have the authority under current law to regulate on this issue.

The federal banking agencies have provided numerous regulations and guidance preempting and interpreting state laws for the benefit of their regulated institutions. State laws protecting consumers in the areas of predatory mortgage lending, electronic deposits, even foreclosure protections, have all been preempted by the OCC and the OTS. Recently the five agencies together issued guidances on issues relating to predatory mortgage lending which were not specifically grounded in any particular federal law -- just the real need to protect consumers from some of the more outrageous abuses occurring in the mortgage market.

The question is whether a bank, acting under the authority of its regulatory agency's guidance, could face any legal jeopardy for failing to attach property which is exempt under federal law. Federal law preempts conflicting state law. Any state law that purports to hold a bank responsible for failing to follow a state law that conflicts with the federal law would be preempted under the Supremacy Clause and traditional preemption analysis.

The Supremacy Clause gives the U.S. Constitution and federal statutes preemptive force. The courts have consistently held that if the provisions of a state law are "inconsistent with an act of Congress, they are void, as far as that inconsistency extends."[48] State or local laws may not stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[49]

Moreover, "[p]reemption may result not only from action taken by Congress itself; a federal agency acting within the scope of its congressionally delegated authority may preempt state regulation."[50] That is, "[f]ederal regulations have no less preemptive effect than federal statutes."[51] Federal agency orders similarly may preempt state or local action.[52] *Even mere letters from a federal agency interpreting an ambiguous statute may preempt state law.*[53]

Federal agency action may preempt state law even if the federal statute itself does not conflict with state law or expressly give the federal agency authority to preempt.[54] In analyzing the preemptive effect of federal agency action, a "narrow focus on Congress' intent ... is misdirected" because an agency's ability to preempt "does not depend on express congressional authorization to displace state law."[55] Federal agencies have considerable authority to preempt as long as their actions are not arbitrary and capricious under the deferential *Chevron* standard.[56]

The federal statutes protecting exempt funds from garnishment or other legal process already preempt any state laws that permit those funds to be frozen. To the extent there is any ambiguity, it is certainly consistent with congressional intent for the banking agencies to issue guidance to their institutions prohibiting the freezing of funds that Congress explicitly protected to meet basic needs. On the other hand, any state law that permits such funds to be frozen – or that imposes liability on banks that comply with federal law -- would conflict both with Congress's intent and with a permissible agency directive and would be preempted.

Conclusion

As Mr. Taliaferro will describe in his testimony, having a bank account frozen when you have no other money is a terrible experience. Unfortunately, Mr. Taliaferro's story is all too typical. We hear from legal services and private attorneys that this is tremendous problem throughout the U.S. that has been escalating in recent years, largely due to the increased number of recipients whose benefits are electronically deposited into bank accounts (due to EFT 99). In the Appendices attached to this testimony are more stories, with as many names, dates and the names of the banks involved as we could put together in this short time frame. All of the banks involved knew of the exempt status of the federal funds they were freezing. All of the banks could have avoided this terrible harm to these recipients of Social Security, SSI and VA funds. There

are case histories from Alabama, Florida, Georgia, Illinois, Michigan, Montana, New York, Virginia, and other states. Unfortunately, for every specific story included in this testimony, there are thousands more. I also include three letters for your attention, one from the Director of a program in western Virginia, one from a lawyer in Florida, and one from a lawyer in New York City. Each of these letters strives to illustrate for you both the depth of this problem to the low income individuals it affects, as well as the huge number of people who are suffering from these continued garnishments and attachments.

I would be happy to answer any questions.

Endnotes

1.
The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer laws, including Consumer Banking and Payments Law (3d ed. 2005), which has several chapters devoted to electronic commerce, electronic deposits, access to funds in bank accounts, and electronic benefit transfers. NCLC also publishes bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted trainings for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal the electronic delivery of government benefits, predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and were specifically very involved in the development of rules implementing EFT-99 after its enactment in 1996. NCLC's attorneys regularly provide comprehensive comments to the federal agencies on the regulations under these laws. Margot Saunders is co-author of the NCLC's Consumer Banking and Payments Law manual, as well as a co-author and contributor to several other NCLC publications.

2.The **Consumer Federation of America** is a nonprofit association of about 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through research, advocacy and education.

3.**Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived form the sale of Consumer Reports, its other publications and services, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

4.The **National Association of Consumer Advocates (NACA)** is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

5. The **National Legal Aid and Defender Association (NLADA)**, established in 1911, is the largest national organization dedicated to ensuring access to justice for the poor through the nation's civil legal aid and defender systems. Among NLADA's more than 2000 members are civil legal aid programs funded by the Legal Services Corporation and a variety of other funding sources.

6. The **National Senior Citizens Law Center** advocates before the courts, Congress and federal agencies to promote the independence and well-being of low-income elderly and disabled Americans.

7.The **National Veterans Legal Services Programs** is an independent, nonprofit, veterans service organization dedicated to ensuring that the U.S. government honors its commitment to our veterans by providing them the federal benefits they have earned through their service to our country. NVLSP accomplishes its mission by: Providing veterans organizations, service officers and attorneys with training and educational publications to enable them to help veterans and their dependents obtain all of the benefits that they deserve; and Representing veterans and their dependents who are seeking benefits before the U.S. Department of Veterans Affairs and in court.

8.The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

9.All of these programs are either multi-county or statewide organizations that advocate on behalf of low income people:
Community Justice Project of Harrisburg and Pittsburgh, Pennsylvania, **Jacksonville Area Legal Aid** of Jacksonville, Florida; **Legal Advocacy Center of Central Florida** in Sanford, Florida; **Legal Aid Society of Roanoke Valley** of Roanoke Virginia; **Legal Services of New Jersey** in Edison, New Jersey; **MFY Legal Services** of New York, New York; **Mississippi Center for Justice** in Jackson, Mississippi; **Mountain State Justice** of Charleston, West Virginia; **Neighborhood Economic Development Advocacy Project (NEDAP)** of New York, New York; **North Carolina Justice Center** of Raleigh, North Carolina, **Virginia Poverty Law Center** of Richmond, Virginia.

10.In 1985, 41.5% of Social Security recipients and 12.4% of SSI recipients received their payments electronically. By 2007, these percentages had risen to 84.1% and 58% respectively. http://www.ssa.gov/deposit/trendenv.shtml.

11.31 U.S.C. § 3332. *See also* 31 C.F.R. § 208.1.

12. *See* 31 C.F.R. § 208.4. It is entirely within the discretion of the recipient to determine whether he or she qualifies for a hardship waiver . The paying agency has no part in deciding whether a recipient is eligible for the hardship exception. The individual recipient determines "in his or her sole discretion" whether electronic fund transfer would impose a hardship. 31 C.F.R. § 208.4(a). "Hardship waivers are solely self-determining, that is, the recipient decides whether receiving payment by EFT would cause a hardship for the recipient. Paying agencies may request that individuals who elect to rely on a hardship waiver notify the paying agency of their intent to rely on a hardship." 31 C.F.R. Pt. 208, App. B.

13.A recent private study commissioned by the U.S. Treasury Department estimated that $100 million was saved by converting from paper checks to electronic payments. Financial Mgmt. Servs., U.S. Department of Treasury, Understanding the Dependence on Paper Checks: A Study of Federal Benefit Check Recipients and the Barriers to Boosting Direct Deposit (2004), available at http://fms.treas.gov/eft/reports/EFTResearch7.27.04FINAL.pdf (study conducted by Federal Reserve Bank of St. Louis).

14.Ellen E. Schultz, "*The Debt Collector vs. The Widow – Viola Sue Kell thought her Social Security benefits were safe in the bank. She was Wrong.*" Wall Street Journal, April 28, 2007. Page A1.

15. Social Security benefits: "The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law." 42 U.S.C. § 407(a).

Veterans benefits: "Payments of benefits due or to become due under any law administered by the Secretary shall not be assignable except to the extent specifically authorized by law, and such payments made to, or on account of, a beneficiary shall be exempt from taxation, shall be exempt from the claim of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, either before or after receipt by the beneficiary." 38 U.S.C. § 5301(a)(1).

Railroad Retirement benefits: "Except as provided in subsection (b) of this section and the Internal Revenue Code of 1986 [26 U.S.C.A. § 1 et seq.], notwithstanding any other law of the United States, or of any State, territory, or the District of Columbia, no annuity or supplemental annuity shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated." 45 U.S.C. § 231m.

Federal Retirement program benefits: "An amount payable under subchapter II, IV, or V of this chapter is not assignable, either in law or equity, except under the provisions of section 8465 or 8467, or subject to execution, levy, attachment, garnishment or other legal process, except as otherwise may be provided by Federal laws. 5 U.S.C. § 8470.

16.*See, e.g., In re Johnson*, 880 F.2d 78, 83 (8th Cir. 1989) (Minn. law); *North Side Bank v. Gentile*, 129 Wis. 2d 208, 385 N.W.2d. 133 (1986); *Vukowich, Debtors Exemption Rights*, 62 Georgetown L.J. 779 (1974).

17.*Wilder v. Inter-Island Stream Navigation Co.*, 211 U.S. 239 (1908); *In re Perry,* 345 F.3d 303 (5th Cir. 2003) (Texas homestead law); *In re Cobbins*, 227 F.3d 302 (5th Cir. 2000) (Miss. law) (liberal construction required, but mobile home not exempt unless debtor also owns land); *In re Colwell*, 196 F.3d 1225 (11th Cir. 1999) (Florida law); *In re Crockett*, 158 F.3d 332 (5th Cir. 1998) (Texas law); *In re McDaniel*, 70 F.3d 841 (5th Cir. 1995) (Texas law); *In re Johnson*, 880 F.2d 78, 83 (8th Cir. 1989) (Minn. law); *Tignor v. Parkinson,* 729 F.2d 977, 981 (4th Cir. 1984) (Va. law); *In re Carlson*, 303 B.R. 478 (B.A.P. 10th Cir. 2004) (Utah law); *In re Casserino*, 290 B.R. 735 (B.A.P. 9th Cir. 2003) (Oregon law); *In re Vigil*, 2003 WL 22024830 (10th Cir. Aug. 26, 2003) (unpublished) (Wyo. law); *In re Winters*, 2000 Bankr. LEXIS 648 (10th Cir. B.A.P. June 26, 2000) (unpublished); In re Kwiecinski, 245 B.R. 672 (10th Cir. B.A.P. 2000); *In re Bechtoldt*, 210 B.R. 599 (B.A.P. 10th Cir. 1997) (Wyo. law); *In re Webb*, 214 B.R. 553 (E.D. Va. 1997); *Levin v. Dare*, 203 B.R. 137 (S.D. Ind. 1996) (where statute unclear, court follows liberal construction rule and holds property exempt); *Marine Midland Bank v. Surfbelt*, Inc., 532 F. Supp. 728 (W.D. Pa. 1982); *In re Morse*, 237 F. Supp. 579 (S.D. Cal. 1964); In re Bailey, 172 F. Supp. 925 (D. Neb. 1959); *In re Wilson*, 2004 WL 161343 (N.D. Iowa Jan. 27, 2004); *In re Moore*, 269 B.R. 864 (Bankr. D. Idaho 2001); *In re Marples*, 266 B.R. 202 (Bankr. D. Idaho 2001); *In re Atkinson*, 258 B.R. 769 (Bankr. D. Idaho 2001); *In re Stratton*, 269 B.R. 716 (Bankr. D. Or. 2001); *In re Siegle*, 2000 Bankr. LEXIS 1627 (Bankr. D. Mont. Dec. 6, 2000), amended, supplemented by 257 B.R. 591 (Bankr. D. Mont. 2001); *In re Moore*, 251 B.R. 380 (Bankr. W.D. Mo. 2000) (principle of liberal

construction required that recreational all-terrain vehicles be included in exemption for motor vehicles where statute did not specifically exclude them); *In re Longstreet,* 246 B.R. 611 (Bankr. S.D. Iowa 2000); *In re Hasse*, 246 B.R. 247 (Bankr. E.D. Va. 2000) (construing Virginia's exemption for IRAs); In re Bogue, 240 B.R. 742 (Bankr. E.D. Wis. 1999) (compilation of Wisconsin cases requiring liberal construction of exemptions); In re Simpson, 238 B.R. 776 (Bankr. S.D. Ill. 1999); *In re Shaffer*, 228 B.R. 892 (Bankr. N.D. Ohio 1998); *In re Rhines*, 227 B.R. 308 (Bankr. D. Mont. 1998); *In re Black*, 225 B.R. 610 (Bankr. M.D. La. 1998); In re Clifford, 222 B.R. 8 (Bankr. D. Conn. 1998) (under Connecticut law, the exemption statute and in particular the tools of trade exemption are to be interpreted liberally); *In re Gallegos*, 226 B.R. 111 (Bankr. D. Idaho 1998); In re Robertson, 227 B.R. 844 (Bankr. S.D. Ind. 1998) (Indiana courts have a longstanding practice of construing exemption statutes liberally in favor of the debtors for whose benefit they were enacted); *In re Brockhouse*, 220 B.R. 623 (Bankr. C.D. Ill. 1998); *In re Cain*, 235 B.R. 812 (Bankr. M.D.N.C. 1998) (North Carolina exemptions should receive a liberal construction); *In re Lazin*, 217 B.R. 332 (Bankr. M.D. Fla. 1998) (Florida exemption for annuity contracts construed liberally in favor of debtor); *In re Hankel,* 223 B.R. 728 (Bankr. D.N.D. 1998) (homestead statutes, like all exemption statutes, are to be accorded a liberal interpretation); *In re Shaffer*, 228 B.R. 892 (Bankr. N.D. Ohio 1998); In re Ward, 210 B.R. 531 (Bankr. E.D. Va. 1997); *In re Evans*, 190 B.R. 1015 (Bankr. E.D. Ark. 1995), aff'd without op., 108 F.3d 1381 (8th Cir. 1997); *In re Powell*, 173 B.R. 338 (Bankr. E.D. Ky. 1994); In re Galvin, 158 B.R. 806 (Bankr. W.D. Mo. 1993); In re Miller, 103 B.R. 65 (Bankr. N.D.N.Y. 1989); *In re Thexton*, 39 B.R. 367 (Bankr. D. Kan. 1984); In re Maylin, 155 B.R. 605 (Bankr. D. Me. 1993); *In re Lind*, 10 B.R. 611 (Bankr. D.S.D. 1981); *In re Avery*, 514 So. 2d 1380 (Ala. 1987); Fleet v. Zwick, 994 P.2d 480 (Colo. Ct. App. 1999); *In re Marriage of Gedgaudas*, 978 P.2d 677 (Colo. Ct. App. 1999); *Wilmington Trust Co. v. Barry*, 338 A.2d 575 (Del. Super. Ct. 1975), aff'd mem., 359 A.2d 664 (Del. 1976); *Havoco of Am., Ltd. v. Hill*, 790 So. 2d 1018 (Fla. 2001) (constitutional homestead exemption is liberally construed); *Goldenberg. v. Sawczak*, 791 So. 2d 1078 (Fla. 2001); *Broward v. Jacksonville Med. Ctr.*, 690 So. 2d 589 (Fla. 1997); *Broward v. Jacksonville Med. Ctr.*, 690 So. 2d 589 (Fla. 1997); *Schuler v. Wallace*, 61 Haw. 590, 607 P.2d 411 (1980); *LPP Mortg., Ltd. v. Meurer*, 2004 WL 57585 (Iowa Ct. App. Jan. 14, 2004) (homestead exemption statutes are broadly construed); *Bohl v. Bohl*, 234 Kan. 227, 670 P.2d 1344 (Kan. 1983); *Celco, Inc. v. Davis Van Lines*, 226 Kan. 366, 598 P.2d 188 (1979); *Dwyer v. Cempellin*, 673 N.E.2d 863 (Mass. 1996) (discussion of public policy of homestead exemptions and liberal construction in favor of debtor); *Carrel v. Carrel*, 791 S.W.2d 831 (Mo. Ct. App. 1990) (exceptions to maximum garnishment restrictions must be narrowly construed); *Household Fin. Corp. v. Ellis*, 107 N.C. App. 262, 419 S.E.2d 592 (1992), aff'd per curiam, 429 S.E.2d 716 (N.C. 1993); *Morgan Keegan Mortgage Co. v. Candelaria*, 951 P.2d 1066 (N.M. Ct. App. 1997); *Meadow Wind Healthcare Ctr. v. McInnes,* 2000 Ohio App. LEXIS 3415 (Ohio Ct. App. July 24, 2000); *In re Anderson*, 932 P.2d 1110 (Okla. 1996); *P.I.E. Employees Fed. Credit Union v. Bass*, 759 P.2d 1144 (Utah 1988); *Homeside Lending, Inc. v. Miller*, 31 P.3d 607 (Utah Ct. App. 2001); *Mercier v. Partlow*, 149 Vt. 523, 546 A.2d 787 (1988); *Macumber v. Shafer*, 637 P.2d 645 (Wash. 1981); *In re Elliott*, 74 Wash. 2d 600, 446 P.2d 347 (Wash. 1968); *Cowart v. Pan Am. Bank*, 2000 Wash. App. LEXIS 2132 (Wash. Ct. App. Nov. 3, 2000) (unpublished); Schwanz v. Teper, 66 Wis. 2d 157, 223 N.W.2d 896 (Wis. 1974). *But see In re McWilliams*, 296 B.R. 424 (Bankr. E.D. Va. 2002) (strictly construing recording requirements of Va. homestead exemption statute); *In re Jackson*, 2001 Bankr. LEXIS 525 (Bankr. E.D. Va. Mar. 30, 2001) (homestead exemption statute is liberally construed, but its procedural requirements are construed strictly, so homestead deed untimely). *But cf. In re Oakley*, 344 F.3d 709, 712 (7th Cir. 2003) (Indiana law) (dismissing rule of liberal construction even though state courts use it).

18. *Bennett v. Arkansas*, 485 U.S. 395, 108 S. Ct. 1204, 99 L. Ed. 2d 455 (1988); *Philpott v. Essex Cty. Welfare Bd.*, 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973).

19.*Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962) (deposited VA benefits retain exempt characteristic so long as they remain subject to demand and use for needs of recipient for maintenance and support, and not converted to permanent investment).

20. *Philpott v. Essex Cty. Welfare Bd.*, 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973).

21.*Bennett v. Arkansas*, 485 U.S. 395, 108 S. Ct. 1204, 99 L. Ed. 2d 455 (1988); *Philpott v. Essex Cty. Welfare Bd.*, 409 U.S. 41, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973).

22.370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962).

23.*See Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962). *See also Jones v. Goodson*, 772 S.W.2d 609 (Ark. 1989) (certificates of deposit purchased with veterans benefits remained exempt; funds were "immediately accessible" even though depositor would forfeit some interest in case of early withdrawal); *Younger v. Mitchell*, 777 P.2d 789 (Kan. 1989) (veterans benefits deposited into an interest bearing savings account exempt); *United Home Foods Dist., Inc. v. Villegas*, 724 P.2d 265 (Okla. Ct. App. 1986).

24.*Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962); *S&S Diversified Servs. L.L.C. v. Taylor*, 897 F. Supp. 549 (D. Wyo. 1995); *United Home Foods Dist., Inc. v. Villegas*, 724 P.2d 265 (Okla. Ct. App. 1986).

25.*Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962); *Younger v. Mitchell*, 777 P.2d 789 (Kan. 1989).

26.*In re Smith*, 242 B.R. 427 (Bankr. E.D. Tenn. 1999) (proceeds of veteran's life insurance policy remained exempt when widow used them to purchase CD, and funds were not commingled with other funds); *Jones v. Goodson*, 772 S.W.2d 609 (Ark. 1989) (key issue was accessibility; depositor could obtain funds at will, although he would be penalized by loss of some interest); *Decker & Mattison Co. v. Wilson*, 44 P.3d 341 (Kan. 2002) (proceeds of workers' compensation settlement, deposited in couple's joint account, then used to purchase CD remained exempt, where funds were traceable and CD a usual means of safekeeping); *E.W. v. Hall*, 917 P.2d 854 (Kan. 1996). *But see Feliciano v. McClung*, 556 S.E.2d 807 (W.Va. 2001) (lump sum workers' compensation award would remain exempt in ordinary bank account, but purchase of CD turns it into non-exempt investment).

27.*See Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962). *See also Jones v. Goodson*, 772 S.W.2d 609 (Ark. 1989) (certificates of deposit purchased with veterans benefits remained exempt; funds were "immediately accessible" even though depositor would forfeit some interest in case of early withdrawal); *Younger v. Mitchell*, 777 P.2d 789 (Kan. 1989) (veterans benefits deposited into an interest bearing savings account exempt); *United Home Foods Dist., Inc. v. Villegas*, 724 P.2d 265 (Okla. Ct. App. 1986) (veterans benefits direct deposited into a bank account and used to pay household expenses "clearly" exempt).

28.*Philpott v. Essex Cty. Welfare Bd.*, 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973); *S&S Diversified Servs. L.L.C. v. Taylor*, 897 F. Supp. 549 (D. Wyo. 1995) (Social Security old age benefits remained exempt when commingled with other funds in joint account, so long as they are "reasonably traceable"; court warned creditors it may impose sanctions for attempt to garnish exempt funds);

29.*Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962). *See also Beardsley v. Admiral Ins. Co.*, 647 So. 2d 327 (Fla. Dist. Ct. App. 1994) (commingling exempt federal retirement funds and non-exempt funds did not destroy exemption; funds should be allocated or traced, if possible); *Dean v. Fred's Towing*, 801 P.2d 579 (Mont. 1990) (Social Security benefits of non-debtor wife remained exempt when commingled in joint account with debtor husband; first-in first-out accounting rule); *NCNB Fin. Servs. v. Shumate*, 829 F. Supp. 178 (W.D. Va. 1993) (first-in first-out accounting rule applied to exempt old age Social Security benefits), aff'd, 45 F.3d 427 (4th Cir. 1994) (table); *In re Radford*, 265 B.R. 827 (Bankr. W.D. Mo. 2000) (lump-sum Social Security Disability payment, received by debtor and deposited in bank account, exempted by "paid or payable" language; no need to determine whether funds necessary for support); *Anderson Boneless Beef v. Sunshine Ctr.*, 852 P.2d 1340 (Colo. Ct. App. 1993) (creditor not entitled to garnish Social Security and supplemental security income checks deposited by debtor for care and maintenance of beneficiaries); *Hatfield v. Christopher*, 841 S.W.2d 761 (Mo. Ct. App. 1992) (where recipient cashed his Social Security check, spent part of it and deposited balance in account commingled with other funds, benefits remained exempt); *Collins, Webster & Rouse v. Coleman*, 776 S.W.2d 930 (Mo. Ct. App. 1989) (Social Security benefits exempt); *Dean v. Fred's Towing*, 801 P.2d 579 (Mont. 1990) (Social Security benefits of non-debtor wife remained exempt when commingled in joint account with debtor husband; first-in first-out accounting rule).

30.*In re Sanderson*, 283 B.R. 595 (Bankr. M.D. Fla. 2002) (recently amended Fla. Stat. § 222.25 exempts tax refunds attributable to earned income credit, even after deposit and commingling). *E.g., Tom v. First Am. Credit Union*, 151 F.3d 1289 (10th Cir. 1998); *In re Nye*, 210 B.R. 857 (D. Colo. 1997); In re Williams, 171 B.R. 451 (D.N.H. 1994); *NCNB Fin. Servs. v. Shumate*, 829 F. Supp. 178 (W.D. Va. 1993), aff'd without op., 45 F.3d 427 (4th Cir. 1994); *In re Mix*, 244 B.R. 877 (Bankr. S.D. Fla. 2000) (workers' compensation settlement remains exempt when deposited in checking account, even if commingled with non-exempt funds, so long as traceable); In re Lazin, 217 B.R. 332 (Bankr. M.D. Fla. 1998); *In re Ryzner*, 208 B.R. 568 (Bankr. M.D. Fla. 1997); In re Norris, 203 B.R. 463 (Bankr. D. Nev. 1996); *Waggoner v. Game Sales Co.*, 702 S.W.2d 808 (Ark. 1986); *Broward v. Jacksonville Med. Ctr.*, 690 So. 2d 589 (Fla. 1997); *Parl v. Parl*, 699 So. 2d 765 (Fla. Dist. Ct. App. 1997); *Beardsley v. Admiral Ins. Co.*, 647 So. 2d 327 (Fla. Dist. Ct. App. 1994); *Decker & Mattison Co. v. Wilson*, 44 P.3d 341 (Kan. 2002) (proceeds of workers' compensation settlement, deposited in couple's joint account, then used to purchase CD remained exempt, where funds were traceable and CD a usual means of safekeeping); *Hatfield v. Christopher*, 841 S.W.2d 761 (Mo. Ct. App. 1992); *Collins, Webster & Rouse v. Coleman*, 776 S.W.2d 930 (Mo. Ct. App. 1989); *Dean v. Fred's Towing*, 801 P.2d 579 (Mont. 1990).

31.*E.g., S&S Diversified Servs. L.L.C. v. Taylor*, 897 F. Supp. 549 (D. Wyo. 1995); *NCNB Fin. Servs. v. Shumate*, 829 F. Supp. 178 (W.D. Va. 1993), aff'd without op., 45 F.3d 427 (4th Cir. 1994); *Dean v. Fred's Towing*, 801 P.2d 579 (Mont. 1990).

32.*E.g., Bernardini v. Central Bank*, 290 S.E.2d 863 (Va. 1982). *See also* Idaho Code § 11-604 (exemptions for insurance, disability and family support are "lost immediately upon the commingling of any of the funds . . . with any other funds"). *But cf. In re Meyer*, 211 B.R. 203 (Bankr. E.D. Va. 1997) (noting statutory protection for unemployment benefits and workers' compensation benefits even if deposited and commingled).

33. New York Community Bank, Astoria Federal Savings and Loan Association, Roslyn Savings Bank, and JP Morgan Chase, for example, as well as other banks in the New York area, have stated in depositions and letters that they examine bank accounts to determine whether they contain only

electronically deposited federally exempt funds, and they "will not honor a restraining order as long as it can be determined that the accounts contain only exempt funds, such as SSI."

34.2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005) (exemption for Social Security benefits in bank account is property right protected by due process clause), later decision, 2006 WL 2013734 (E.D.N.Y. July 18, 2006) (denying defendants' motion for interlocutory appeal).

35. *See* 142 *Cong. Rec.* H48721 (1996).

36.245 Mont. 366, 801 P.2d 579 (1990).

37. 245 Mont. at 371, 582.

38.The accounting system we recommend would be "First In, Last Out" (aka "FILO") to be applied to all exempt funds. Under this system, all exempt funds would be considered to be deposited first on a given day, and withdrawn last – ie. first in and last out. Consider the following example of how this would work:

Day 1 – Deposit of $700 exempt funds.	Balance $700	$700 exempt	$0 non-exempt
Day 3 – Deposit of $200 non-exempt funds.	Balance 900	700 exempt	200 non-exempt
Withdrawal of $50.	Balance 850	700 exempt	150 non-exempt
Day 4 – Withdrawal of $300	Balance 550	550 exempt	0 non-exempt.
Day 5 – Deposit of $200 non-exempt funds.	Balance 750	550 exempt	200 non-exempt

39.*See, e.g.* West's Ann.Cal.C.C.P. § 704.080.

40.We have done a review of all state laws and it appears that in every state an attachment or garnishment order clearly only applies to non-exempt funds. In a minority of states, there is some ambiguity surrounding the issue of whether the "exempt status" of the funds only applies upon the debtor's taking some action. However, that would conflict with the specific protection of the federal statutes at issue here – where the Supreme Court and others have already said that Social Security, SSI and Veterans Benefits retain their exempt status from before the time they are paid to the recipient until after they are paid to the recipient. A state procedure that purports to say that these funds are not exempt unless the recipient comes forward to claim them directly conflicts with this protection and would be clearly preempted.

41.Advocates for low-income consumers in some states have succeeded in changing the forms provided to banks with attachment or garnishment orders, prohibiting banks from applying the orders to accounts that hold only funds electronically deposited by the Social Security Administration. See, e.g., Pa. R. of Civ. Proc. Rule 3111.1. The new rules protect funds that are "on deposit in a bank or other financial institution in an account in which funds are deposited electronically on a recurring basis and are identified as funds which upon deposit are exempt from attachment . . . ." Pa. R. of Civ. Proc. Rule 3111, Note, reprinted at http://www.aopc.org/OpPosting/Supreme/out/471civ.5attach.pdf. "Under the amended rules, the judgment creditor rather than the defendant has the burden of raising an issue with respect to exempt payments within the scope of new Rule 3111.1. The defendant need not file a claim for exemption as exempt funds are not attached." Pa. R. of Civ. Proc. Rule, Civil Procedural Rules Committee Explanatory Note, reprinted at http://www.aopc.org/OpPosting/Supreme/out/471civ.5attach.pdf.

42. Colorado, Minnesota, and Virginia.

43.Indeed in some states, the treatises on civil procedure make it explicit that a bank will suffer no legal jeopardy for refusing to attach exempt funds. *See, e.g.* 1 New York Civil Practice: CPLR P 5251.14. ("There are two exceptions to the general principle that a willful transfer or interference with property or debts covered by a valid restraining notice is punishable as a contempt. *First, there is no contempt if the property is exempt* under CPLR 5205 or CPLR 5206 , or under any other provision of law." (footnotes omitted))

44.*See* cases cited in note 17.

45.*See Todd v. Weltman*, 434 F.3d 432 (6th Cir. 2006); *Rahaman v. Weber*, 2005 WL 89413 (Minn. Ct. App. 2005) (procedure for claiming exemption, including damages if creditor seized exempt property, did not preclude common law causes of action for conversion against creditor and its attorneys).

46. *Chung v. Bank of Am.*, 2004 WL 1938272 (Cal. Ct. App. 2004) (unpublished) (stating that bank garnishee had duty to verify whether funds were exempt, not creditor); *Lukaksik v. BankNorth, N.A.*, 2005 WL 1219755 (Conn. Super. Ct. Apr. 26, 2005) (plaintiff pleaded exceptional circumstances sufficient to maintain action for breach of fiduciary duty); *Branch Banking Trust Co. v. Bartley*, 2006 WL 1113632 (Ky. Ct. App. Apr. 28, 2006) (father sued bank that allowed creditor to garnish non-custodial account containing minor son's funds; bank raised genuine issue of fact on counterclaim that father breached fiduciary duty by setting up ordinary joint account and failing to respond to creditor's garnishment notice). *But see, Gorstein v. World Sav. Bank*, 110 Fed. Appx. 9 (9th Cir. 2004) (bank has no duty to determine whether portion of funds in account were exempt); McCahey v. L.P. Investors, 774 F.2d 543 (2d Cir.1985) (debtor's interest in preserving non-exempt property for his or her own use is ... subservient to the creditor's judgment, meaning that bank has no duty to determine exempt funds).

47.This practice is separate from the problems caused when banks promote overdraft "protection loans" to Social Security recipients and bleed the accounts through high overdraft fees. Although this practice was declared legal in *Lopez v. Washington Mut.*, 302 F.3d 900 (9th Cir. 2002), it is still very bad public policy. NCLC describes these transactions as "bounce loans" because any benefits from the program are far outweighed by the costs. However, the financial services industry generally refers to them as "bounce protection" or "courtesy overdrafts." *See* Consumer Federation of America and National Consumer Law Center, *How Banks Turn Rubber Into Gold by Enticing Consumers to Write Bad Checks* (Jan. 27, 2003), available at http://www.consumerlaw.org/action_agenda/bounce_loans/appendix.shtml.

48.Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 31 (1824); *accord* Lorillard Tobacco Company v. Reilly, 533 U.S. 525, 541 (2001); Crosby v. National Foreign Trade Council, 530 U.S. 363, 373 (2000).

49. Hines v. Davidowitz, 312 U.S. 52, 67 (1941); *accord* Crosby v. National Foreign Trade Council, 530 U.S. 363, 372-73 (2000).

50.Louisiana Public Service Commission v. Federal Communications Commission, 476 U.S. 355, 370 (1986); *see generally* Lauren Saunders, Preemption as an Alternative to Section 1983, Clearinghouse Review Journal of Poverty Law and Policy 705, 109-10 (March–April 2005).

51.*Fidelity Federal Savings and Loan Association v. De la Cuesta,* 458 U.S. 141, 153–54 (1982); *accord* Capital Cities Cable v. Crisp, 467 U.S. 691, 699 (1984); *see Watters v. Wachovia Bank, N.A.*, 127 S.Ct. 1559 (2007) (finding state law preempted by federal regulation).

52.*See, e.g., Entergy Louisiana Incorporated v. Louisiana Public Service Commission*, 539 U.S. 39, 47 (2003).

53.*See Estate of F.K. v. Division of Medical Assistance and Health Service,* 2005 WL 13252 (N.J. Super. Ct. App. Div. Jan. 4, 2005) (finding that federal Medicaid Act as interpreted in U.S. Department of Health and Human Services' letter preempted conflicting state regulation counting spouse's annuity as an asset of plaintiff); Blackwell, 61 F.3d 170 (3d Cir. 1995) (finding that Hyde Amendment as interpreted by federal Medicaid bureau director's letter preempted state regulation restricting Medicaid funding for certain abortions).

54.*See City of New York v. Federal Communications Commission*, 486 U.S. 57, 63 (1988); *see also Watters v. Wachovia Bank*, 127 S.Ct. at 1582 & n.24 (Stevens, J., dissenting) (complaining that the majority found a regulation preemptive even though Congress did not authorize the federal banking agencies to preempt state law).

55.Fidelity Federal, 458 U.S. at 154; accord City of New York, 486 U.S. at 63.

56.New York v. Federal Energy Regulatory Commission, 535 U.S. 1, 16, 18 (2002) (citing Chevron U.S.A. Incorporated v.
Natural Resources Defense Council., 467 U.S. 837, 842–43 (1984)); City of New York, 486 U.S. at 63.

Appendices to Testimony
of
Margot Saunders
National Consumer Law Center

Appendices includes case histories of recipients of Social Security, SSI and other federal benefits who have suffered after banks have frozen their bank accounts containing electronically deposited funds.

Case histories are provided from the following states:

Alabama
Georgia
Illinois
Michigan
Mississippi
Montana
New Jersey
Nevada
New York
Pennsylvania
Virginia

In addition, there are letters from legal aid attorneys describing the problems caused to their clients from three legal aid programs:

Neighborhood Economic Development Advocacy Project in New York, NY
Legal Advocacy Center of Central Florida, Inc. in Sanford, Florida
Legal Aid Society of Roanoke Valley, in Roanoke, Virginia

Alabama

Ethel Silmon is a 59 year old, widow. Her only income is Social Security Disability of $889 per month. She has been on disability for several years due to severe anxiety, depression, COPD, and a heart condition. She had a credit card for years and paid regularly until she became disabled and could no longer work. After she became disabled, her income dropped dramatically and she could no longer pay the credit card debt. She defaulted on the debt. The credit card company charged off the debt. The debt was bought by Unifund CCR Partners, who sued her and got a judgment against her for $13,474. They started harassing her to collect the judgment.

Her Legal Aid attorney told her that she was judgment proof and that her income was protected. Her attorney also helped her submit a letter to her bank (Wachovia) about her exempt status. They also sent a letter to the debt collector explaining that Mrs. Silmon's only income was exempt from judgments.

Despite the letters, after obtaining a judgment, the debt collector filed a Writ of Seizure against Mrs. Stilmon's bank account held by Wachovia. The bank promptly froze her bank account. The writ was for $15,895.44 and the bank informed Mrs. Silmon and her attorney that they would not release the funds in the client's bank account until the full amount was collected or they received a court order dismissing the writ. At the time, Mrs. Silmon had less than $1,000 in the bank and she had written checks for her mortgage, electricity, medical expenses, and groceries that the bank refused to honor. The bank also charged Mrs. Silmon overdraft fees on each of the checks she had written.

The Legal Aid attorney called the bank several times, as well as the creditor, and the creditor's attorney. All call were ignored. The attorney filed several motions with the court to dismiss the writ. Almost a month after the funds were frozen in her Wachovia account, the writ was dismissed, the funds were released, and the overdraft fees were refunded.

During the month without access to her money, Mrs. Silmon suffered several severe anxiety attacks, she had to go to the food bank for food, and had to rely on her doctors for samples of medicine. She is still fearful that they will try it again and states that she can not handle it if they do.

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Georgia

Ms. T F is a 43-year-old resident of Wilkes County, Georgia. In 1999, Ms. F was in a car accident that left her unable to walk for over a year. She has had approximately ten surgeries on her legs and feet since the accident. After her accident, she used her credit card to meet her expenses because she did not have any income. After the credit card company raised the minimum monthly payment amount, she was no longer able to make the payments and the credit card company subsequently received a default judgment on the debt. In 2001, Ms. F began receiving Social Security disability income.

On March 29, 2006, the credit card company filed a garnishment against a bank account held by Ms. F at Regions Bank. The garnishment summons instructed Regions Bank to immediately hold all property belonging to Ms. F "except what is exempt." On April 3, 2007, the Social Security Administration electronically deposited $1,012 in disability income into her bank account. That same day, Regions Bank froze her account, withdrew $807.57 pursuant to the garnishment, and then withdrew an additional $75 for a garnishment fee. After the checks Ms. F had previously written all bounced due to the freeze on her account, Regions Bank charged Ms. F an additional $217 in NSF fees.

Ms. F learned about the garnishment on April 7, when she attempted to make a withdrawal at her local branch. She told the branch employees that she had Social Security in her account and they could not freeze it. An employee told her to get a lawyer to write a letter to the bank stating that Social Security is exempt and the bank might be able to release the funds. Ms. F asked a local attorney to write such a letter pro-bono and then took the letter to the bank branch. Ms. F did not know that Georgia Legal Services Program could assist her with a garnishment and she could not afford to hire a private attorney.

On May 11, 2006, the bank filed an answer in the superior court asserting that $807.57 in the account is subject to garnishment. It subsequently sent the money to the registry of the clerk, who then forwarded the money to the creditor. The garnishment answer form has a space for the bank to list the amount of exempt funds in the bank account. The bank did not describe any of the money in the account as exempt.

Ms. F had to borrow money from her family to pay the NSF fees and other charges charged by merchants after her checks bounced. She had to postpone a surgical operation on her knee because she could not afford to travel to the doctor's office during this ordeal. The garnishment cause Ms. F significant stress and she could not afford to fill her prescriptions Nexium and Celebrex. Her inability to take these medicines, combined with the stress caused by the garnishment, caused her to eat significantly less during the month of April. She lost approximately fifteen pounds that month.

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Illinois

This is a letter from this client to Senator Baucus

Juanita Johnson
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September 17, 2007

Senator Max Baucus
Chair, Committee on Finance
U.S. Senate
Washington, D.C.

Dear Senator Baucus:

My name is Juanita Johnson. I am 74 years old and my only income is from Social Security and a VA pension.

In March 2005, a judgment was entered against me from an old credit card account. When I was originally sued on this account, I went to court to explain that I believed I had paid the bill in full. I had cut up my credit cards seven years earlier and no longer had any records of the account. I tried to reach the original credit card company, but they were no longer in business. The judge gave me a list of attorneys, but no one would agree to represent me. I went to court myself and objected and told the court I did not owe the money. I asked for documentation about the account. The collection lawyer said that his client had bought the account and that this was all interest I supposedly owed. He gave the court an affidavit from his company and a judgement was entered against me over my objections.

A few months later, I was commanded to come back to court to disclose my assets. I was sworn under oath and interviewed outside the courtroom where I told the collection lawyer that my only income was my VA pension and Social Security. He said, "Well you need to make arrangements" to make payments, so I agreed to pay the $20 a month. I was not aware that my Social Security and VA pension were exempt from garnishment.

I made some payments, but even $20 per month was more than I could afford. In late 2005, I had to go into a nursing home temporarily and missed two payments. Then all of a sudden in January, 2006, I received notice from my bank that my rent check had bounced. My landlord also called me screaming, "what is going on?" I had never had a problem paying my rent before. I couldn't understand what in the world was going on, so I contacted my bank and was informed that my account was frozen.

I was very upset, constantly crying, I was a basket case, and I had to be admitted to a psychiatric hospital for four days on heavy medication after my account was frozen. Finally, I was able to reach a legal aid lawyer who advised me that my income was exempt from garnishment, and no collectors should be able to take it even after it was deposited in the bank.

I was without access to my funds for three weeks, and bounced about six checks - the bank charged me $25 per check, plus $150 for the citations freezing the account, plus fees for overdraft and late fees on my other bills. I had to ask my doctor to write a letter to electric company to keep my lights on, and had to make arrangements with the phone company to keep my phone service. Finally my lawyer was able to get the freeze lifted, but only after the collection lawyer said they had no record of my many conversations with them where I told them my only income was pension.

Then they didn't show up when my lawyer went to court after they agreed to lift the freeze, and it was another four days without access to my money. The bank explained to me that they act immediately when they get the order to freeze the account, but they took their time releasing my funds even after they got the order lifting the freeze.

I have direct deposit, so my bank could easily know that my only deposits in the account were from my VA pension and Social Security.

Sincerely,

Juanita Johnson

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Michigan

A 59 year-old, disabled man from Muskegon contacted CALL after SSD and VA benefits were wrongfully garnished from his bank account, resulting bounced checks and the accrual of overdraft fees. CALL's attorney intervened with the creditor and the bank, obtaining both the return of $586 in garnished funds and a credit for $66 in overdraft fees.

A disabled woman in Van Buren County contacted CALL following the garnishment of her bank account, which was comprised entirely of SSD and SSI benefits. The Social Security benefits were the woman's sole source of income, and this fact was known to the judgment creditor due to evidence produced at a debtor's exam several months prior to the garnishment. The hotline attorney was successful in convincing the opposing attorney to lift the garnishment without forcing the woman to resubmit proof of receipt of Social Security benefits (which would have caused a hardship to the woman, who suffers from mental illness), and also in convincing the opposing attorney to persuade his client cease all further collection activity against the woman, since the attempt to knowingly garnish exempt funds arguably constituted a violation of the Fair Debt Collection Practices Act.

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Michigan

Betty Reignbow (age 62) of East Lansing Michigan, had her bank account garnished sometime around August 7, 2007, even though virtually all the funds in her account came from Social Security and SSI disability payments. Betty is in her mid-60s, has numerous disabilities, and cares for her adult disabled son who is in his twenties. The funds that go into Ms. Reignbow's account at Fifth Third Bank each month are $511 for her own social security (plus another $69.70 in SSI funds), and $530 from her son's disability. During the month prior to the garnishment, her church gave her $200 to fix a broken pipe in her home, and this sum was also deposited in the account. She learned on August 7, 2007 that her bank account had been frozen, when she tried to buy gas with her ATM card. Despite repeated pleas to the bank her money was not released until a month later when her cousin, who is a law professor, contacted the bank's lawyer. In the meantime her September income from SSA was frozen as well.

Mrs. Reignbow survived during the month without access to her funds because of the kindness of her relatives.

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Mississippi

Client is 59, on social security disability for severe arthritis & anemia. She was sued on a credit card on 11/19/2004 and timely answered 12/15/2004, stating among other things in her answer that she was disabled and unable to make payment, and the answer was filed of record. So, at all times creditor was on notice of disability. Despite having answered, a default was taken against her without notice on May 31st, 2005, in the amount of $9768.18, plus interest, attorney's fees and costs, and on March 13th, 2007, again without notice, a garnishment was entered in the amount of $16, 380.16. No notice was given her of the garnishment.

At the time of the garnishment she had $3,421.13 representing a current month's social security check for 688.00 clearly apparent on her account transaction record and exempt pursuant to 42 U.S.C. Section 407 and a FEMA award for her Katrina losses also exempt by law.

No notice was sent her by her major national bank of the garnishment until her checks began to bounce at which point on April 16th, she was mailed an insufficient funds notice by her bank which did not reference the garnishment, her exemption rights, or how to assert her exemptions.

Client had life insurance, and Medicare prescription Part D payment automatically deducted. She told the bank her funds were all Social Security and FEMA funds and she was told there was nothing they could do. They did direct her to the creditor's attorney, who - most unusually - released the garnishment but the Court did not send a copy to the bank. It was not until August 27th that we were able to convince the bank to release the funds, this took me over 4 hours on the phone and fax machine. To date they still have not refunded the bounced check charges.

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Montana

June Tift – Billings, Mt.

Ms. June Tift has been disabled since childhood due to a traumatic brain disorder. She is 51 years old this year and lives in Billings, MT on Social Security of about $720 per month. She contacted Montana Legal Services Association (MLSA) after Chase Bank obtained a default judgment against her, and US Bank – the bank in which her Social Security funds had been electronically deposited – had permitted Chase to sweep her account. We were able to provide proof of her Social Security to the creditor's attorney and he returned the $107.74 swept, but US Bank would not return their "Non-Refundable" Levy fee of $75.

Even after we showed Chase's attorney that Ms. Tift's only income was exempt Social Security income, he sent a collection notice to Ms. Tift on a Discover card account. We contacted him and reminded him of Ms. Tift's collection proof status and he closed his account. Unfortunately, Discover sold the account to Johnson Rodenburg & Lauinger who began collection efforts in the summer of 2006. MLSA sent them a letter of representation and demanded that they cease contacting our client and informed them she had only Social Security for income. For months they continued to contact our client in violation of the Fair Debt Collection Practices Act. In February 2007, an attorney from Johnson Rodenburg and Lauinger contacted MLSA and asked for proof of Ms. Tift's Social Security. In April 2007, MLSA sent proof of her Social Security status. In July 2007, despite the repeated notices that Ms. Tift's only income is exempt, Johnson Rodenburg and Lauinger filed suit against Ms. Tift to collect her Discover debt which has grown to over $6000, because of additional fees and interest. MLSA is representing Ms. Tift in that action.

Dan Murray- Livingston, Mt

Mr. Murray, of Livingston, Mt., contacted MLSA when his bank account at Wells Fargo was attached because of a judgment from an old credit card debt. Wells Fargo allowed approximately $80 to be taken from his account. Mr. Murray lives entirely on SSDI and VA Compensation benefits of approximately $860 per month. He is 56 years old. He became disabled when he broke his neck and back. His back injury healed poorly and is inoperable. He has not been able to return to work as a truck driver. Mr. Murray contacted MLSA through our statewide Helpline and with the information provided, he was able to file his own request for a hearing on exempt funds and had his $80 returned to his account, but he too lost his "Non-Refundable Levy Fee" of $65 from Wells Fargo. He has since closed his bank account so that he does not have to fear further sweepings of his account. Mr. Murray is contemplating bankruptcy at this point because he continues to get calls from collection agencies and fears being sued again and having his benefits taken out of his bank account.

Lois O'Brien

Ms. O'Brien is a 60 year old woman on SSDI. She was sued by Collection Bureau Services of Missoula Montana for unpaid medical debts. Although she is on SSDI she had not yet been awarded Medicare and she had substantial medical bills. Her bank account at US Bank was swept and she contacted MLSA. MLSA was able to contact the attorney for Collection Bureau Services who agreed to lift the levy upon seeing proof of her SSDI and returned the $207.00 to O'Brien. Unfortunately, US Bank would not return their $75 Non-Refundable levy fee. Ms. O'Brien closed her account with US Bank and has moved to Rapid City, South Dakota.

Unfortunately, I have many more stories like these. I would say that on average we get one or two of these types of cases per week. We know there are many more Montanans out there who never come to MLSA and do not know how to get their exempt funds back once they are attached. I hope these stories help.

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New Jersey

Ms. H found out about a levy on her bank account when she went to buy needed medication. Of course, she was unable to purchase her meds because the creditor levied both her savings and checking accounts. This lady's sole source of income was exempt funds, and therefore the entire balance of each account was completely exempt. Moreover, each levy was for an amount less than the New Jersey statutory $1,000 exemption, and even collectively did not exceed $1,000.

Ms. H's legal aid lawyer contacted the creditor's counsel and provided documents to show that the funds were entirely from Social Security and therefore exempt from attachment. The creditor's attorney wrote to the Levy Officer at the bank to have the bank funds released. However, the bank did not respond for more than a week, and the court clerk insisted that there was nothing that could be done to free up Ms. H's funds in the absence of cooperation from the bank. The state court procedure permitted an appeal to the court for an order releasing the levies, but the judge assigned to hear these appeals was away on vacation. At this point, our client had been without her medication for more than a week.

The legal aid attorney contacted the attorney for the bank and requested assistance. With the cooperation of the creditor's plaintiff's counsel, the bank finally agreed to release Ms. H' funds.

The process took over two weeks, during which time Ms. H was without her life supporting medication, as a result her health deteriorated.

Attorney

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New York

Anne D., 45, a Pilates instructor who suffers from mental illness and lives in Manhattan, discovered that her bank account, which contained only exempt funds, was frozen when she attempted to withdraw cash from an ATM last October. The victim of identity theft, Ms. D. was never served with a summons and complaint or a restraining notice, and did not know a default judgment had been entered against her in another county. While her account was frozen, Ms. D. could not pay her rent, buy food, or purchase medicine. In addition, her bank charged her fees for returned checks. Although a bank manager helped Ms. D. contact the plaintiff's attorney and even informed the attorney that Ms. D.'s account contained only exempt funds, the bank said it could not violate the restraining order by lifting the restraint on its own. The account remained frozen until Ms. D. successfully vacated the default judgment several weeks later.

The funds in Ms. D.'s accounts at that time consisted of Supplemental Security Income (SSI), which is exempt from collection pursuant to 42 U.S.C. § 407, and earned income, which is exempt from collection, pursuant to N.Y. Social Services Law § 137-a. The bank was Citibank.

George M., 57, of Manhattan, worked for the U.S. Postal Service for 22 years, and for the New York State Department of Motor Vehicles for five years, before he became disabled and unable to work approximately four years ago. Now homebound because he is unable to walk without great difficulty, he relies on his Social Security Disability checks, which are directly deposited into his bank account. Despite the fact that all of his income is exempt from collection, his bank account was frozen last June. "I thought that because my money comes from the federal government, they knew they couldn't touch it, but they did anyway," he said of the creditor. Because Mr. M. is homebound, he pays all his bills -- including his rent -- online, through his bank account. Once his bank account was restrained, he had no way of paying his bills, and considered closing his bank account to prevent it being restrained again.

The bank was Chase.

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New York

Ms. B, is a 72 year old resident of Washington Heights. Her only income is her monthly Social Security check. She deposits her check into a Chase checking account each month, and writes checks against it to pay her rent, her utility bills, and various other monthly bills, including several credit card accounts. Since her income is not sufficient to pay all of her monthly bills, she receives loans of money from time to time from family members, which she deposits into her Chase account.

Shortly, after September 27, 2005, Ms. B received a notice from Chase informing her that the bank had been served with a restraining order by a judgment creditor. The amount of the judgment, which resulted from unpaid dental bills, was $920.15. At the time, Ms. B's account balance was $929.54. Under New York Law (CPLR § 5222), the bank is required to freeze up to double the amount of the judgment for one year. There are also provisions allowing the account holder to vacate the restraint under certain circumstances, such as when the funds in the account are exempt from execution.

On September 29, 2005, a $53.83 check that Ms. B had written to Time Warner Cable Company on September 25, 2005 was presented to Chase for payment. Since there were no unrestrained funds in the account to pay the check, Chase refused payment, charged Ms. B a $30 NSF fee, and debited her account $30, reducing the balance from $929.54 to $899.54

This process repeated itself throughout October and November. On September 30, 2005, the bank refused payment on a $30 check to Household Finance and debited Ms. B's account for another $30. On October 3, 2005, the bank refused payment on three more checks and debited Ms. B's account for $90 - - $30 for each check. On October 4, 2005, the bank charged $60 in NSF fees for two additional checks, including a second charge for the $53.83 check to Time Warner Cable which had been presented to Chase for the second time. On October 5, 2005, Chase debited the account for another $60 because two "pre-authorized debits" - - one for $4.15 and one for $0.95 - - could not be completed. Ms. B had at some point authorized the bank to withdraw small amounts from her account every month to cover some card issued by the bank.

Over the following months, the bank pre-authorized withdrawals for $4.15 and $0.95 were blocked by the restraining order. By November 22, 2005, the funds in Ms. B's checking account were completely exhausted. The bank continued to charge NSF fees, however. The account balance had reached -$637.79 by the time Chase zeroed out the amount on April 12, 2006. (This was $1,567.33 less than the starting point on September 27, 2005).

The net result of this series of events is that Ms. B's lost the entire $929.54 which had been in the account on September 27, 2005. (In fact, her losses were probably higher than this if, as is quite likely, her other creditors charged her late fees when Chase refused payments on checks Ms. B had written to them). Meanwhile, the judgment creditor who had executed on her bank account received exactly nothing: Because Chase's NSF fees consumed the entire account balance, there was nothing left over for the dentist. In effect, the serving of the execution by the

judgment creditor caused the entire balance of Ms. B's account to be transferred, not to be judgment creditor, but to Chase.

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Nevada

We have had a number of clients recently who are having bank accounts garnished and the banks have done a couple of things that we don't believe are right - one action is to charge the client's bank credit card if the amount in the checking account is not sufficient to pay the garnishment levy (e.g. Wells Fargo checking account does not contain $400, but the issued Wells Fargo Visa credit card has $400 of credit on it, bank simply pays the $400 and charges the credit card, the garnishment notice from the creditor was for "bank accounts"); the second action is paying off the entire amount of the garnishment levy when the client does not have the amount in the checking account, but the client has overdraft protection, and the bank then charges the client the fees for the overdraft (e.g. garnishment levy is for $400, client has $100 in checking account, bank pays $400 creating $300 overdraft and charges client $45 fee under the overdraft protection).

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Pennsylvania

J and his wife, now deceased, purchased a Ford Focus automobile and entered into a retail installment contract for the purchase. After defaulting on this contract, the car was repossessed and sold, and a default judgment was entered against them for the deficiency, costs, and attorney fees totaling $12,370.64.

J has been disabled and unable to work since 1996 and is now sixty-seven years old. His sole source of income is Social Security disability payments of $963.00 per month.
J is a customer of CSB Bank, where he has a checking account into which the monthly Social Security payments are electronically deposited each month. On each such electronic deposit, a notation is prominently displayed identifying the source of such deposits: "SSA US TREASURY 303 SOC SEC."

J's creditor on the judgment against him and his wife obtained a writ of execution from the court clerk, which was served on CSB Bank, instructing it to attach all J's bank accounts that are subject to attachment. Although CSB Bank had actual knowledge that the funds in J's account were Social Security payments (and therefore exempt from both execution and attachment), the bank nevertheless freezed J's account for more than a month.

J's account was eventually unfrozen, but CSB Bank charged J $340.00 in legal fees on the basis that it incurred fees to clear up the matter. These charges were simply taken by CSB Bank from J's account at the bank which contained only Social Security benefits.

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Virginia

Mrs. Ruby Fauntleroy is 74 year old resident of Arlington, Virginia. She is a grandmother living in low-income housing. She tried for years to pay off the Capitol One debt (about $4,000, incurred mostly due to medical needs). She would pay $50 per month, but they demanded more, telling her that she might as well send nothing, if she's only going to send $50/month. So, she said ok. Now, due to interest and late fees, that same debt is up to about $7,000.

After Capitol One obtained a judgment against her in Richmond, Virginia, a garnishment order was also in Richmond. Her bank account in Arlington was frozen pursuant to the garnishment order before her legal aid attorneys had sufficient time to have the case removed to Arlington or for her to submit any response. However, both the Mrs. Fauntleroy's own Arlington bank and Capitol One, the garnishor, were notified in person and in writing about the exempt status of the fund in her bank account.

When her bank account was frozen, she borrowed money to pay her rent; she stopped the direct deposit of her SSA check to her bank; she stopped buying medicines; she started buying money orders to pay her bills. Money orders are difficult because she has physical difficulty getting around, and no transportation other than public. And, money orders drive up the cost of paying her bills.

But, she is now too frightened of the banking system to trust them again. So, she keeps a few dollars in her account to keep it open, but is too afraid to use it.

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September 17, 2007

Margot Saunders
National Consumer Law Center
1001 Connecticut Avenue, NW
Washington, D.C. 20036

Re: Restraint of bank accounts containing exempt income

Dear Margot:

I write to describe a problem of epidemic proportions that affects seniors and people with disabilities in New York City. That problem is the restraint and seizure of bank accounts containing exempt income, such as Social Security and SSI, by debt collectors.

I am a Staff Attorney at the Neighborhood Economic Development Advocacy Project (NEDAP), where I direct NEDAP's Consumer Law Project. One of my responsibilities at NEDAP is to staff and direct the NYC Financial Justice Hotline, which provides free legal advice, information, and referrals to low income residents of New York City facing problems involving abusive lending and debt collection practices. Launched in September 2005, the Hotline is one of the only resources in New York City for low income people who need help with consumer problems. With one attorney, one paralegal, and a handful of interns and volunteers, we have served more than 2,000 individuals in the last two years.

The single most important issue affecting our clients is the restraint of bank accounts containing exempt income, such as Social Security and SSI. For example, in the first six months of 2007, we took 91 calls from individuals who could not access their exempt funds because they had been frozen by a debt collector. We receive approximately 15 calls per month on this topic. We estimate that 20% of our workload is devoted to helping people gain access to their government benefits and other exempt funds that have been deposited into bank accounts and then wrongly restrained by debt collectors.

When our clients lose access to their exempt income, they often fall behind in rent and utility payments or go without food. They have to borrow money from friends or roommates just to survive. Perhaps more important is the psychological toll of losing access to funds that represent a lifeline. Many of our clients live in fear that their account will be frozen multiple times. Some close their bank accounts and resort to paper checks, money orders, and check cashers because they cannot tolerate the uncertainty. Others make payment agreements that they cannot afford, going without necessities because they feel they have no choice if they wish to protect their income from restraint. As a final sting, the banks charge our clients up to $150 for each restraint, plus $35 for each check bounced while the account was frozen. This money is often not refundable and can easily amount to one quarter or even one third of our clients' total monthly income.

Below are case examples of clients who have called our Hotline because their exempt income was restrained by creditors:

1. Ms. Cassandra Suggs lives with her eleven year old daughter in public housing in New York City. She banks with Apple Bank, a New York State bank. Ms. Suggs has a number of outstanding credit card debts that she has been unable to pay since she became disabled about four years ago. She is currently homebound and in a wheelchair due to osteoarthritis and various other medical problems. Her only income is Supplemental Security Income (SSI). Her daughter is also disabled and also receives SSI.

Recently, Ms. Suggs was sued by a debt buyer on one of her old credit card accounts. She was not served with a summons, and her first notice of the lawsuit occurred when her bank account containing her SSI was frozen in September 2007. She notified the plaintiff's attorney of her exempt SSI income. Because she had deposited some of her daughter's SSI as cash into her own account to pay some bills, the attorney accused her of having commingled funds and refused to release the account. Our office eventually assisted Ms. Suggs to obtain a court order vacating the judgment and releasing the funds. But during the one month period that she had no access to her money, she could not pay rent and she received a notice of pending eviction from the public housing authority. Ms. Suggs is now one month behind in her rent and is also behind in her utility bills. Her bank charged her a legal process fee of $150, which they have not reversed.

2. Mr. L is 62 years old and disabled due to a heart condition. He is largely homebound, and lives on less than $700 a month in Social Security and pension benefits. When Mr. L began receiving letters from debt collectors about two years ago, he worried that his creditors would seize his exempt income, leaving him unable to pay his rent and medical expenses. Mr. L asked his bank – Chase Bank – whether it could protect his exempt income from creditors. A Chase employee stated that if the bank received a restraining order, it would have no choice but to freeze Mr. L's exempt funds, and that it would most likely take him three to six months to obtain their release. After this conversation, Mr. L cancelled his direct deposit and closed his bank account. For several years, he spent $57 each month to cash his check -- $27 on check cashing fees and $30 on a car service (he was unable to walk the three blocks to the closest check casher).

Recently, Mr. L decided to open a bank account again after he was diagnosed with terminal cancer and a friend of his was robbed at knifepoint after cashing her Social Security check at a local check casher. Two months later, his checking account at Commerce Bank was frozen by a debt collector even though it contained nothing but directly deposited exempt benefits. Although Mr. L eventually negotiated release of his account, he was without access to his funds for over a week.

3. In April 2007, Ms. Henrietta Sue Green's bank account at Chase Bank was frozen by a creditor who had obtained a default judgment against her. Ms. Green is a senior and disabled; she survives on Social Security, Workman's Compensation, and a small pension. Upon learning of the restraint, Ms. Green immediately notified the creditor and her bank that her account contained only exempt funds, but the creditor maintained the restraint for 13 days. During this time, Ms. Green was unable to buy food or medicine and had no money for transportation. She suffered unbearable anxiety and lives in fear that her account will be restrained again.

In October 2006, a debt collector restrained Ms. Beth Spine's bank account even though it contained nothing but directly deposited Supplemental Security Income. Ms. Spine had no access to her account for five weeks, and she lost two months of benefits. She had to apply to a local charity for funds to

pay her rent, and she had to borrow money for food from her roommate. Eventually, she agreed to make $50 payments in return for the release of her exempt funds, which never should have been restrained. In addition, her bank charged her $100 for processing the restraint. Approximately 7 months later, after paying off the first account, Ms. Spine was sued by a different debt collector. Although she disputed the debt, Ms. Spine agreed to make $25 monthly payments because she felt that if she did not agree to make payments, her account would be frozen again. Ms. Spine feels that her SSI benefits are not safe in the bank, and that the federal protections are meaningless. Ms. Spine cannot afford these payments and has been skipping meals and undergoing other privations in order to pay the debt collectors.

We have many more stories just like those above. Please let me know if I can provide you with more information about this distressing problem.

Sincerely,

Claudia Wilner
Staff Attorney

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September 17, 2007

Margot Saunders, Esquire
National Consumer Law Center
1001 Connecticut Avenue, NW
Washington, D.C. 20036

Re: Garnishment of exempt benefits

Dear Ms. Saunders:

We write to support your testimony regarding the adverse effects resulting from garnishment of clients' bank accounts which contain direct deposited Social Security and other exempt benefits. I offer some descriptions of particular incidents, and enclose a copy of a complaint we filed on behalf of a current client against a national bank whose legal order processing policy hurts low income families.

Legal Advocacy Center of Central Florida, Inc. is a non-profit legal services program handling impact cases throughout a 12 county area in Central Florida. We work closely with the federally funded Community Legal Services of Mid-Florida, Inc. (previously Central Florida Legal Services, Inc., Withlacoochee Area Legal Services, Inc. and Greater Orlando Area Legal Services, Inc.). We have provided legal aid services since 1969 through a variety of predecessor agencies. We currently handle a region of approximately 485,000 low income persons which includes approximately 55,640 disabled persons.

Since January 1, 2007, CLSMF and LACCF have served 845 clients with

representation, advice, or referral in matters of debtor relief and consumer defense. About 54% of these were disabled or retired former workers or their dependents who had no earned income or are dependent upon Social Security disability, retirement, survivor's or dependent benefits, Supplemental Security Income (SSI) or other federal or state benefits exempted by law from levy or garnishment by creditors.

Most of our clients receiving these benefits are strongly encouraged to receive a direct deposit each month from the U.S. Treasury or state source into their individual bank accounts. This saves them from the cost of cashing their checks, safeguards their money until it is needed, provides regular statements showing their expenses, and gives them the capacity to pay landlords, utility companies, grocery stores, and other creditors by check.. Furthermore, having a bank account is convenient, or even necessary, as many low income retirees have limited access to transportation or are shut-ins. When these clients' only resources are restrained, they may go hungry or without daily essentials, often including medical care and medication, electricity and other household expenses.

In a particularly egregious illustration of this problem, Deloris W.'s Wachovia bank account was frozen in 2005 due to a NY default judgment obtained without her knowledge. Their Wachovia account contained two direct deposit Social Security checks and a small private disability check for the husband. All funds in their account were exempt from garnishment under Florida and federal law. She had not lived at the New York address where service was made for over three years. She and her disabled husband have been Inverness, Florida residents since 2004. When the garnishment attached, Ms. W. had no access to any funds to pay for her regular living expenses. She signed a release for the bank to issue a check for $3107.47 to the judgment creditor so that she could keep the remaining funds in her account ($1482.64). She did so under pressure because Mr. W. was scheduled for chemotherapy and they needed some money for the chemotherapy treatment co-pay. Pursuant to its deposit agreement, Wachovia took $100 out of the account for its legal processing fee.

In 2006, LACCF filed suit in Volusia County, Florida to challenge the practice of Wachovia Bank N.A.'s honoring out-of-state garnishment orders against bank accounts which contain exempt funds. In *Judith Graziano v. Wachovia Bank* (Case

2006-31052-CICI), Volusia County, Florida, Wachovia, acting pursuant to receipt of a New York default judgment, restrained all funds in Ms. Graziano's bank account, including Social Security funds, without following any of the Florida post-judgment garnishment procedures. Ms. Graziano had not been a resident of the state of New York for 4 years when her account was frozen. *Fla. Stat.* 77 provides that all judgment debtors are entitled to notice of their right to claim exemptions and an opportunity for a prompt hearing before a local court to determine whether the funds restrained are exempt. Wachovia has defended this suit, arguing that it is obligated to freeze the exempt funds pursuant to the New York garnishment order and that Ms. Graziano, as a Florida resident, is not entitled to the protections of Florida garnishment procedures.

We would be happy to provide additional details, if needed.

Sincerely,

TREENA A. KAYE
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HENRY L. WOODWARD — General Counsel

Senator Max Baucus
Chairman, Senate Committee on Finance
United States Senate
Washington DC 20510

Re: Garnishment of exempt federal benefits

Dear Senator Baucus:

I understand that your Committee is investigating the problem of creditor garnishment of exempt Social Security and other federal benefits from bank accounts of recipients. This is a chronic and serious problem in the part of Virginia served by my legal services program. I would like to bring our experience to your attention, and to that end will describe that experience, attach some client stories, a newspaper article, a court order and form, and copies of the letters our clients receive from banks when they are garnished.

1. I am General Counsel (executive director) of a state-funded legal services program of four lawyers which shares primary responsibility with a federally-funded office of one lawyer for meeting the civil legal needs of 32,053 low income people in a five-county area around the city of Roanoke, Virginia.

2. The Legal Aid Society in the twelve months ending June 30, 2007 served 388 clients with representation, advice, or referral in matters of debt relief and consumer defense. About half of these were disabled or retired former workers or their dependents who had no earned income or earning potential, but were at best dependent upon Social Security disability, retirement, survivor's or dependent benefits; Supplemental Security Income (SSI); Veteran's benefits; Railroad Retirement; Black Lung; Temporary Assistance to Needy Families (TANF);

Worker's Compensation; or other federal or state benefits exempted by law from levy or garnishment by creditors.

3. Most of our clients with these forms of benefit income receive it by direct deposit each month from the U.S. Treasury or state source into their individual bank accounts. This method is advantageous in that saves them from the cost of cashing their checks, safeguards their money until it is needed, provides regular statements documenting their accounts, and gives them the capacity to pay landlords, utility providers, grocery stores, and other creditors by check, which is less costly than money order and furnishes better proof of payment.

4. Most of our clients who are elderly or disabled have in their earlier lives prided themselves on keeping their bills paid and their credit clean. For many it is a source of humiliation and anxiety when their reduced income no longer allows them to pay such major debts as medical bills or credit card accounts swollen beyond recognition with assorted charges and mushrooming interest. Many go hungry or without daily essentials in the effort to keep up with obligations they can no longer realistically afford to pay.

5. An average of about two disabled or elderly clients per month come to Legal Aid with the complaint that their Social Security or other federal benefits have been frozen by creditor garnishment of the bank account into which they were directly deposited. The client is never aware that this is happening until after the freeze is in effect. I believe the debtors who come to us with this problem are just the tip of a large iceberg of affected persons.

6. Sometimes these frozen benefits are the only funds in the account, and the only source of income for the subsistence of the client. Often, however, our clients have withdrawn and re-deposited a portion of their benefits, or deposited trivial amounts of other funds such as refunds from purchases or gifts from relatives. The banks claim that this ordinary

use of accounts makes it difficult to isolate the exempt benefits and they can't tell what's exempt and what's not.

7. Virginia statutes provide that a garnished person must be notified of possible exemptions and given an opportunity to claim them. This process requires gathering of bank statements and award letters, application to the issuing court, notice to the creditor, and a real-world minimum of two weeks after filing to get to court. In our experience the courts hearing such exemption claims are sympathetic and generally order release of exempt benefits that can be proved. Another week or ten days is often required before the release order is actually implemented by the financial institution holding the exempt funds.

8. By the time of their release, however, substantial damage has been done. Mortgage or rent payment checks have bounced, placing shelter at risk. Utility providers may have shut off vital heat or lights or gas. For each bounced check there is a fee to be paid to the frustrated payee, a fee to be paid to the bank, and the risk of criminal prosecution if all is not taken care of immediately. The fees are rarely refunded despite court order for release of the exempt funds.

9. Almost by definition our clients receiving exempt benefits have some degree of impairment or disadvantage (mobility or mental or educational or all three) which makes it difficult for them, without help, to thread the needle of application for their garnishment exemption to be recognized. Frequently the experience of losing income they thought was safe triggers anxiety and panic, leaving a traumatizing effect often as serious as the loss itself.

10. Most benefit recipients who experience this sad sequence of events choose to switch their benefit payments to direct mailing to their homes instead of direct deposit to their bank accounts. Often another month of benefits is frozen before the request for home delivery can be processed. Those who give up direct deposit place themselves in the slippery hands of

exploitative check cashers and corner store money order merchants, and become easier marks for purse snatchers and conniving relatives.

11. In 2006 we represented disabled client John Wheeler to challenge garnishment of his Social Security from Wachovia Bank. The bank never even responded to our motion for contempt for freezing exempt funds. The court held Wachovia in contempt and imposed sanctions (order attached). When this result came to the attention of the banking community, they successfully lobbied Virginia's Administrative Office of the Courts to change the form garnishment order which had previously compelled a garnished bank to honor the exemption.

12. The answer form which Virginia courts furnish to a garnishee (attached) still permits the garnished bank to respond to the garnishment by checking a box which says "The funds held by the garnishee consist solely of direct deposited federal benefits and are statutorily exempted from garnishment." We are not aware of any bank serving our clients which regularly makes use of this answer in appropriate cases.

13. Instead the four major banks serving this part of Virginia (Wachovia, SunTrust, Bank of America, and BB&T) all appear to maintain multi-state policies of freezing and, if not ordered otherwise, turning over the exempt benefits to the court for distribution to the garnishing creditor. Each of them also, as a matter of policy, charges its customer a fee of $100 for the "service" of surrendering their customer's exempt funds to the garnishment (attached bank notice letters). This fee is not regulated by state law, and is generally not restored to the account even if a court orders release of the exempt funds.

Thank you for considering this information. Please let me know if any further details would be useful.

Respectfully yours,

LEGAL AID SOCIETY
Henry L. Woodward

LEGAL AID SOCIETY OF ROANOKE VALLEY
September 17, 2007

SAMPLE CLIENT STORIES – GARNISHMENT OF EXEMPT BENEFITS
(Some clients identified by case number only pending consent)

STEPHEN AND VIRGINIA MEADOWS, CASE 07-5000219. Disabled couple living in Roanoke VA received $924 per month in Social Security and SSI as only income for both of them. Judgment against husband on credit card debt was obtained in Richmond VA by Capital One. In February 2007 BB&T notified them that their joint account, where all their federal benefit checks were directly deposited, was frozen by garnishment and $100 charge deducted. Their March checks came into the same account and were also frozen. They faced loss of utilities, cancellation of car insurance and foreclosure on home. Applied to Richmond court by mail for exemption, about a month after the freeze their funds restored less bank charges.

JOHN WHEELER, CASE 06-5000420. Resident of Boones Mill VA suffered disabling spinal and nerve damage from a back injury at work, and lived entirely on $1001 per month of Social Security. A credit card debt buyer obtained judgment against him on old credit card debt and garnished his Wachovia Bank account, consisting entirely of direct deposited disability benefits, in April 2006. He was unable to pay his share of monthly expenses to the relatives with whom he lives, and could not pay for his pain relief medicine and other essential incidentals. The Legal Aid Society moved to have Wachovia held in contempt and sanctioned for disregard of the garnishment order's admonition to honor the exemption for directly deposited exempt federal benefits. Wachovia chose not to respond, and upon the bank's default the Franklin County General District Court held Wachovia in contempt and ordered damages and attorney fees to the debtor. When this result came to the attention of the banking community, they successfully lobbied Virginia's Administrative Office of the Courts to remove the direction to honor exempt benefits from the form garnishment order.

GARY HUGHES, CASE 07-5000393. Disabled man in Roanoke VA with bipolar disorder and agoraphobia lived entirely on $922.50 per month in directly deposited Social Security disability benefits. In 2005 he received notice from SunTrust Bank that his account was frozen but managed to negotiate release (but not refund of the $100 bank fee) without applying to the court. In March 2007 SunTrust notified him of another garnishment, for a Roanoke judgment obtained by a debt buyer of an old credit card account. The bank charged his account $100 and froze the rest. Only because of his prior experience did he know to take quick action, and by application to the court was able to recover his funds, though not the bank charges, in time to prevent loss of shelter and utilities.

ZONNIE STEWART, CASE 07-5000257. A 70-year old woman in Blue Ridge VA lived entirely on Railroad Retirement survivor benefits directly deposited to her SunTrust Bank account. Capital One Bank obtained judgment against her in Richmond for credit card debt and garnished her bank account. She is wheelchair bound, blind in one eye, and suffers from cerebral palsy and diabetes and is unable to get to court. When she came to Legal Aid in February 2007 her rent, telephone and cable bills were overdue. Release of her exempt funds was obtained about a month after the freeze by application to the Richmond court, but the bank retained its $100 garnishment fee.

BRENDA TRAN, CASE 06-5001410. Disabled resident of Forest VA lived only on monthly Social Security disability benefits of $603 directly deposited in a Bank of America account. Capital One obtained judgment in Richmond VA on a credit card debt and garnished her account. When she was notified of the garnishment in November 2006 the bank had already charged her account a $100 fee and frozen the remaining $16. She avoided loss of the next month's benefits only by promptly applying to the Richmond court, which ordered the garnishment released. The bank restored the funds to her account only after another week's urging.

CASE 06-5000413. A 67-year old Roanoke VA woman, homebound from diabetes and other maladies, received Social Security disability benefits directly deposited to SunTrust Bank as her only source of income. In April 2006 she suffered judgment on a credit card debt in Richmond Virginia by

Capital One, which then garnished her bank account. The bank froze her account and imposed a $100 service fee. Her account statement was confusing because she regularly withdrew and then re-deposited sums for her living expenses, though it was all from the benefit source. To meet the concern of co-mingled funds, she had to apply for exemption of $1403.35 under Virginia's Homestead Exemption law to cover the account, which seriously depleted her $5000 lifetime allotment of homestead rights. The freeze on her benefits caused her scheduled electronic mortgage payment to be refused, putting her house at risk. Although the Richmond court ordered release of the account, SunTrust took an extra week to comply, so that the client did not get use of all her exempt funds for over a month from the freeze.

CASE 07-5001003. Homebound disabled woman in Blue Ridge VA lived entirely on Social Security and SSI disability benefits of $643 per month directly deposited into her SunTrust Bank account. Judgment against her on credit card debt was obtained by Capital One in Richmond. In July 2007 her bank notified her that her account was frozen by garnishment and $100 fee charged. Her August checks were also frozen before she could stop direct deposit of benefits. When she reached Legal Aid in August her rent, medical co-pays, insurance premiums, and utilities had gone unpaid and she was unable to buy food. She applied to the Richmond court by mail for exemption, and the funds less charges were restored to her about two weeks later.

SOUTH BROOKLYN LEGAL SERVICES

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Statement of Waverly Taliaferro
Consumer/ Social Security Recipient
New York, New York

September 20, 2007

Senator Max Baucus, Chair
Senate Finance Committee
Washington DC 20510

Re: September 20, 2007 Hearing concerning freezing of bank account

Dear Senator Baucus and other members of the Senate Finance Committee,

Thank you for inviting me to speak today.

My name is Waverly Taliaferro. I am 70 years old. I was born and raised in Virginia. I served two years in the U.S. Army in the "Proving Grounds" of New Mexico as a motion picture photographer. After leaving the Army, I married my wife, Millie and continued working in the photography industry. In 1980, we moved into a studio apartment in New York City where we still live today. In 2001, I retired at age 65.

Since retiring in 2001, my income is limited to my Social Security check. It is currently $1508 a month. I have no nest-egg. While my wife Millie, recently started to work, her wages are not great.

Like others, Millie and I got credit cards while working. We never believed we could not pay them. However, life sometimes throws you a curve-ball. In 2003, Millie lost her job. Because the rent on our studio apartment is more than half my Social Security check, this left only about $600 a month to pay for food, medicine, utilities, and other necessities. Consequently, Millie couldn't pay her credit card bill.

On Monday, August 14, 2006, the credit card debt caught-up with us. Our bank account at Citibank was frozen. Millie was not working. The account had only $47 in it, all of which was left over direct deposit Social Security from July. I was not even aware of the freeze until Wednesday, August 16, the day my next direct deposit Social Security check was due. I learned of the freeze when I tried to withdraw money from an ATM to buy groceries. A Citibank employee could not help me, but told me to find a lawyer.

Millie, through persistence and luck, found a lawyer the next day at South Brooklyn Legal Services. Our lawyer gathered papers, all from the bank, and then on day seven of the freeze, faxed them with a letter to the creditor's lawyer. Our lawyer thought the account would be open in a week.

Of course bills were coming due (ConEdison, cable, phone, and rent.) While we had family in Virginia, Millie and I thought we could and should weather this on our own.

Eleven days after the account was frozen, the creditor wanted more information before it released the account. Our lawyer thought this request excessive, but not illegal, and that complying would be quicker than going to court (a two to three week procedure.) On day fifteen, the creditor added a new condition. Millie had to call them to work out a payment plan before it would release the account. Since Millie had no income, this meant my Social Security. After our lawyer threatened to sue them, the creditor told Citibank on day 18 of the freeze to release the account. Not until day 23 did Citibank unfreeze it.

I then discovered that Citibank had taken $45.00 as a fee for honoring the restraint. While it wasn't a huge amount of money, it seemed like they owed me an apology, not a charge. Although both I and my lawyer asked Citibank to return the fee, it never did.

Getting by with no money for 23 days was quite difficult. We ate all our staples, spent the silver dollars I'd saved as keep-sakes, and then survived off a ten pound bag of brown rice. Eating brown rice, three times a day, Sunday to Saturday, is pretty tedious. Amazingly, neither Millie or I got sick. Rather, we just lost weight. I lost forty pounds. Millie's dress size went down three sizes.

During those 23 days, we got used to being hungry. We got used to having no entertainment other than walking to the library or reading a book. We got used to the creditor's delay tactics.

But what we couldn't, and haven't gotten use to is the fear that this dehumanizing experience could happen again. One morning we could find ourselves again eating rice and scrounging for loose change in the sofa.

Since August 2006, I've gotten my Social Security in the mail. To cash it, I have to go to a seedy Cash Checking store on 9th Avenue. It's slightly unnerving; a lot of unhappy poor people loitering and waiting in line. I pay $23.00 to cash my $1509 Social Security check. Millie worries that someone will mug me. But what upsets me is my loss of dignity. I worked all my life and earned my Social Security check. Each time I enter the cash checking store, I feel like a cheat or welfare recipient incapable of pulling my life together.

In March 2007, my lawyer called me with good news. J.P. Morgan Chase had a written policy that it would not restrain a bank account that contained only direct deposit Social Security. In other words, I could safely bank again. So I opened an account at Chase. I even got a $100.00 signing bonus when I told them I wanted direct deposit. This made me feel great, like a big leaguer. Sixteen days later, my Chase account was frozen again. My March Social Security check was then directly deposited into the frozen account, becoming unavailable.

My lawyer explained that Chase was legally correct in restraining the account as it contained $25.25 in left over money from the $100 signing bonus. Luckily, Millie was working by this time, and we did not have to go hungry during this second freeze. Getting the Chase account released, even with my lawyer helping me, took about a month and involved the same song and dance as before. I lost money in bank fees as well.

Millie and I are good people. We have worked all our lives. We are exploring our options for dealing with our debts. Until then, we need a safe place to deposit my Social Security check. When I was in the New Mexico Proving Grounds 50 years ago, I saw the government use its energy and intellect to create powerful weapons that kept us safe. Senators, please apply that same energy and intellect to this simple problem.

Thank you.

_____-s-_____
Waverly Taliaferro
New York, New York

Supporting Statement of Johnson M. Tyler, Esq.
SSI Unit Director
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September 20, 2007

Senator Max Baucus, Chair
Senate Finance Committee
Washington DC 20510

Re: September 20, 2007 Hearing concerning freezing of bank account

Dear Senator Baucus and other members of the Senate Finance Committee,

Waverly Taliaferro's story is sadly typical.

Social Security Is Exempt From Debt Collection

For the last 18 years, I have worked at a legal services office helping disabled and impoverished New Yorkers qualify for Social Security and Supplemental Security Income benefits (also known as SSI.) SSI is a need based benefit that pays about $650 a month, while

Social Security is based on a person's work history and pays from $300 to well over $1500 a month.

For most of my clients, a monthly SSI or Social Security check is their only income. Take it away, and they would not be able to pay their rent, buy food, or purchase medicine. Indeed, about 750,000 New Yorkers have no other source of income other than their monthly Social Security or SSI checks.[1] Because Social Security and SSI are this nation's original safety net, it's illegal for creditors to take either benefit. 42 U.S.C. § 407(a) and § 1383(d)(1) .

Debt Collectors Are Freezing Social Security Benefits

Until about 2001, very few SBLS clients had problems involving creditors taking their Social Security payments.[2] This has changed radically in the last few years. Now, I and other legal services offices regularly receive calls from elderly or disabled persons with the same problem as Mr. Taliaferro.

While Restraining A Bank Account Containing Social Security Is Easy and Legal , Lifting the Restraint is Difficult

This scenario occurs not due to some scam, computer hacking, or deceptive debt collection practice. Rather, it is completely legal (although I and others are challenging the Constitutionality of the practice.[3]) And getting an account unfrozen, even when it contains only exempt Social Security payments (that the creditor has no legal right to) is time consuming, cumbersome, and likely to fail if the debtor is unrepresented. The prescribed method to lift a restraint is either to go to court and prove the account contains exempt money (NY CPLR 5239 and 5240), or to try to negotiate a settlement with the debtor (by proving the account contains only Social Security.) Either of these routes typically take 2 - 4 weeks, during which time the Social Security recipient must borrow money, get help from food pantries, and beg for patience with his or her landlord. Ironically, the evidence one needs to prove the exemption - bank statements showing the origin of the money is direct deposit Social Security- is held by the bank who could have asserted the exemption in the first place. And when the bank account is unfrozen, the Social Security recipient's account balance has been reduced by $100 - $300 in bounced check and legal processing fees collected by the bank.

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[1] These numbers are derived from the Social Security Administration's publication, *Fast Facts & Figures about Social Security*, (June 2003) which is available at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2003/.

[2] In Huggins v. Pataki, 2002 U.S. Dist. LEXIS 13664 (E.D.N.Y. 2002), SBLS first challenged the constitutionality of restraining a bank account containing only direct deposit social security. That claim was dismissed and appealed to the Second Circuit. However, the plaintiff died prior to the Circuit ruling on the appeal, effectively mooting out the case. Accordingly the appeal was withdrawn.

[3] See Mayers v. N.Y. Cmty. Bancorp Inc., No. CV-03- 5837, 2005 WL 2105810.(E.D.N.Y. Aug. 31, 2005.)

The result is that the Social Security recipient often gives up on banking for fear of a future restraint. Not having a bank account is expensive - a cash checking place typically charges $10.00 to cash a $700 check. Not banking also increases the burden on the police and local social service agencies as paper checks and cash can be stolen.

Why Bank Restraints Involving Social Security Are Increasing

How prevalent is this problem? While there are no statistics, anecdotal evidence suggests it is quite common in New York. I get five to eight calls a week on the subject at SBLS. Other factors suggest the problem is huge. First, many Social Security recipients have credit card debt, having lost income when they became disabled. Second, more Social Security recipients today have bank accounts than in the past. This is because Congress made direct deposit mandatory in 1996 (although there is an opt-out provision.) As a result, 80% of Social Security recipients today have bank accounts.[4] In New York, this translates into about 500,000 impoverished Social Security recipients who need access to their bank accounts to get their direct deposit Social Security payments.[5]

Third, the safe-harbor of bankruptcy was significantly reduced by the 2005 bankruptcy amendments. Personal bankruptcy filings dropped about 75% from over 2 million in 2005 to 590,000 in 2006.[6] Consequently, many elderly and disabled Social Security recipients who would have availed themselves of bankruptcy in the past to avoid repeated bank freezes are unable to do so today.

Fourth, New York's debt collection laws are exceedingly powerful. Once a creditor has won a judgment in a New York court (having proven the debt is owed or winning because the debtor failed to appear), a creditor will issue information subpoenas with restraining notices on local banks commanding them to freeze any account involving the debtor. Unlike in other states, creditors with judgments in New York can issue these restraining notices directly from their offices without the cost of going to court. This makes searching for a debtor's bank account cheap and fail-proof as literally every bank in the state can be served to locate a debtor's account. For example, one creditor recently served restraining notices on 30 banks in New York in search of my client's account. These banks included such little known banks as "The Atlantic Bank of New York" "The Bank of Smithtown," "The First Niagra Bank," and "The Nassau Educators Federal Credit Union." Needless to say, the creditor found and restrained my client's account (which contained only Social Security by direct deposit.)

Debt collectors also have technology on their side. A 2000 amendment to New York law

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[4] See The Social Security Administration's *Trend In Direct Deposit Participation* (June 2001) (available at www.ssa.gov/deposit/GIS/data/Reports/DDTREND.htm.).

[5] These numbers are derived from the Social Security Administration's publications, *Fast Facts & Figures about Social Security*, (June 2003) available at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2003/ and *Trends In Direct Deposit Participation* (June 2001) (available at www.ssa.gov/deposit/GIS/data/Reports/DDTREND.htm.).

[6] Blair, *"Insolvency Cases Plummet"* The New York Law Journal, April 26, 2007.

allows "electronic" service of restraining notices and information subpoenas. CPLR 5222(g) and 5224(a) (4). Now, a collection firm need not drop-off hundreds of pieces of paper with banks requesting information on judgment debtors. Instead, a firm serves the banks with a CD-ROM disc containing the names and social security numbers of thousands of judgment debtors. For example, one small bank recently received a CD-Rom from a large collection firm containing information on 65,000 debtors. The bank ran this through its computers in 4 minutes, locating the accounts of over 100 debtors. This same CD was given to numerous banks who likewise froze the accounts of hundreds of debtors. Another large debt collector uses technology that allows bank matching of debtors names with bank accounts through the internet.

As a result of this technology, Social Security recipients can no longer hope that a restraint is a one time event. Today, issuing a restraining notice is so cheap that a creditor will try again in hopes that the debtor has won lotto, inherited money, returned to work, or commingled his account. Or the creditor will sell the judgment to a third party who will then restrain the account again. Accordingly, the problem of low income persons having their exempt Social Security restrained by creditors is huge and will not go away.

What Can Be Done To Protect Social Security Recipients?

Banks have all the technology they need to protect direct deposit Social Security payments. Each electronic deposit contains words and coding that identifies it as a Social Security payment. Thus, a bank employee or a computer can easily determine if an account contains only exempt, direct deposit Social Security payments when the bank is served a restraining notice. Most banks will not do this because New York law does not require this extra step. Moreover, many banks believe they will be held in contempt if they do not restrain the account, given language on the restraining notice and in the NY CPLR 5222(b).

Federal agencies could easily require banks to take this extra step - to not honor any restraining notice where an account contain only direct deposit. One bank, the New York Community Bank, already follows such a practice of ignoring restraints when the account contains only direct deposit Social Security.(Affidavit available upon request.) A number of banks, including Chase and Banco Popular, also protect such accounts.

Moreover, making banks take this extra step of looking at the account before restraining it is not burdensome. California and Connecticut already require banks to do this to protect direct deposit Social Security. Conn. Gen. Stat. § 52-367b(c)and Cal Code Civ Proc § 704.080. Many large banks, such as Bank of America, are thus taking this extra step for Social Security recipients in select states. They should do it for all the nation's citizens.

Finally, it is very important that when an account contains non-exempt money, that the bank restrain only the non-exempt portion. As Mr. Taliaferro's second restraint in March 2007 illustrates, having as little as $25.00 in your account can trigger the loss of one's entire Social Security check (in his case $1508.) Bank's have the technology to easily determine what money is exempt and not exempt. They just are not forced to do so. Meanwhile they enjoy all the fees triggered by the freeze.

Conclusion

Banks need to do the right thing to protect Social Security recipients such as Mr. Taliaferro from debt collectors. Without guidance from federal regulatory agencies, they will not do so. The Senate Finance Committee should make sure such guidance is given.

Thank you.

_____-s-_____
Johnson M. Tyler
Brooklyn, New York

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

COMMITTEE ON FINANCE

of the

UNITED STATES SENATE

September 20, 2007

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

INTRODUCTION

Chairman Baucus, Ranking Member Grassley, and members of the Committee, my name is Julie Williams, and I am Chief Counsel and First Senior Deputy Comptroller of the Office of the Comptroller of the Currency (OCC). Today's hearing highlights the hardships faced by recipients of Social Security, Veterans', and other federal benefits when they are unable to access funds in their deposit accounts to meet their day-to-day living expenses because the account has been frozen in response to a garnishment order. We appreciate the opportunity to present the views of the Office of the Comptroller of the Currency on this problem. My written statement covers four key points:

First, we completely agree that there is a problem that needs to be addressed.

Second, this problem is complex. No one agency has the solution. A solution will require involvement and actions by multiple agencies, including those before you today and other agencies as well. The issues presented include unclear and undefined provisions of Federal law, state laws and judicial processes that may unintentionally produce results conflicting with Federal public policy objectives, and questionable practices by debt collectors. The issues presented also implicate important Federal policy objectives affecting how Federal benefits payments are made.

Third, there are certain things that the federal banking agencies can do – and we will do – to help, and I discuss those initiatives later in this statement. But the actions that we can take are not a complete solution.

Finally, obtaining a comprehensive resolution of these issues will require coordinated action by multiple parties on multiple fronts. It could well require Congress to enact legislation to clarify intersections of Federal and State law, unless agencies such

as the Social Security Administration and Department of Veteran's Affairs conclude that, under their respective statutes, current law provides them sufficient authority to provide definitive answers to key unresolved issues in this area. We defer to those agencies to advise the Committee on whether or not they have sufficient authority to address these concerns under existing law.

Description of the Problem

The process for garnishing a consumer's deposit account is generally established by state law and state judicial processes. While the specific processes vary among states, they generally contain some common elements. For example, a creditor typically will obtain an order from a state court enabling collection on a default judgment by garnishing or levying against the debtor's funds or other property. Generally, state laws require that the debtor be provided notice of the issuance of, or request for, a garnishment or similar order. In many cases, state laws or court orders direct a financial institution receiving a garnishment order to place a freeze or hold on the customer's account. This step was designed to preserve the funds in the account and to provide the customer with an opportunity to assert any exemptions or challenges to the garnishment order. However, as we see today, it may also result in significant hardships for customers because they are unable to use the account for any purpose during the freeze. Where financial institutions impose a freeze on an account, as noted above, they are doing so pursuant to court orders or state law procedures.

Many state laws also prescribe the contents of the notice, and some require that information be provided to the debtor about the types of funds that are exempt from

garnishment and about how to claim those exemptions. For example, the laws of Arizona, Florida, Illinois, and New York provide model language for the notice to the debtor, which includes a statement that state and federal law may limit the types of funds that may be garnished. The model notice provides specific examples of exempt funds such as Social Security and other federal benefits, and it explains how a debtor may claim an exemption. Generally, a consumer may request a hearing on these claims, and these notices also typically provide information on how to request a hearing. In most states, either the creditor or the court provides these notices to the debtor. In a small number of states, a third party such as a depository institution that receives a court garnishment order must mail a copy of the order and applicable notices to the debtor.

In order to claim that some or all of the funds targeted by a garnishment order are exempt, state laws typically appear to require the debtor to assert the exemption(s) as an affirmative defense to the garnishment proceeding. The state laws with which we are familiar generally do not impose an affirmative obligation on depository institutions to determine whether the targeted assets are exempt from garnishment. A couple of states take a different approach, however. For example, Pennsylvania and California provide an exemption to their general procedures in debt collection cases involving Social Security or other specified benefits that are directly deposited into an account on a recurring basis. It is our understanding that Pennsylvania rules provide that where the debtor's funds are deposited electronically on a recurring basis and are identifiable as exempt, the bank or other financial institution holding the account should not attach any of the funds on deposit. California law provides that a specified amount in each account containing direct deposits of Social Security funds may not be attached ($2,425 for

accounts with one depositor and $3,650 if two or more depositors receive Social Security benefit payments). The debtor must follow state procedures and request an exemption for any funds in excess of the statutory minimum amounts.

Changes in technology, and changes in business practices, appear to be contributing to the severity of the recent concerns relating to debt collection actions against consumers receiving federal benefits payments. Over the past several years, a market has developed for the purchase of old, previously uncollectible consumer debts. These debts often are purchased in bulk from creditors, sometimes for pennies on the dollar, by so-called debt buyers. These collection accounts sometimes are repackaged and sold to small debt collection firms whose business model involves flooding small claims courts with collection actions. New reports indicate that these filings often may contain incorrect addresses for the alleged debtors, resulting in these individuals never receiving notice of the collection action. Many mass debt collection filings result in default judgments against the debtor. Advocates for these debtors assert that these filings sometimes lack documentary evidence of the validity of the debt and have been permitted to go forward even where questions exist concerning whether the debt collection is time-barred.

When a court grants a default judgment, debt collectors can now use e-mail to blanket depository institutions with demands on any funds on deposit belonging to the debtor. Frequently, these demands are mass mailed to banks in circumstances in which the debt collector may not have any reason to believe that a debtor has an account at the institution, or that any such account contains funds that lawfully may be attached.

When a deposit account is frozen pursuant to a court order, consumers generally are required by state laws or regulations to establish that their accounts contain exempt funds before the garnishment order may be dissolved, and before the freeze on access to the funds may be lifted. Unfortunately, nothing appears to prevent the debt collector from filing a new claim, and serving a depository institution with a new court order, on a regular basis thereafter seeking those same funds. We understand that some debt collectors repeatedly seek to levy against accounts after the consumer has established that the account contains exempt funds – and even though the debt collector does not have a reasonable basis to believe that nonexempt funds have since been deposited into the account that may be available for attachment or garnishment. In these situations, the consumer must again raise the exempt status of funds in the account as a defense to the action, and repeat the procedural steps required by state law, or else risk loss of his or her funds. These types of processes can present significant consumer hardships, and they are particularly daunting for elderly and disabled recipients of federal benefits payments.

The Problem is Complex

The issues underlying this problem are complex, in no small part due to significant uncertainty regarding the scope and application of provisions in Federal law protecting recipients of federal benefits payments against garnishment and attachment of their funds. For example, section 207 of the Social Security Act provides that "the right of any person to any future payment under this subchapter [of the SSA] shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment,

garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law."[1] This describes the basic protections provided for Social Security benefits. But it does not address what depository institutions should do when faced with court-issued garnishment orders directing a freeze or hold on funds in a customer's account – which may or may not lead to a garnishment. To our knowledge, the Social Security Administration has not spoken to this point and its internal Program Operations Manual System ("POMS") provides that the "responsibility [of the Social Security Administration] for protecting benefits against legal process and assignment ends when the beneficiary is paid" and "if a beneficiary is ordered to pay his/her benefits to someone else, or his/her benefits are taken by legal process, he/she can use [section 207] as a personal defense against such actions."[2] Our informal consultations with legal staff of the Social Security Administration have been consistent with the view that section 207 is a defense available to be asserted by the customer defense against garnishment.

Courts generally have reached similar conclusions on the matter, treating federal benefits as property rights protected by the Due Process Clause, and holding that the applicable garnishment or similar procedures established by state law must provide consumers sufficient notice and opportunity to contest the garnishment.[3] However,

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[1] 42 U.S.C. § 407(a). Payment of Veterans' benefits "shall be exempt from the claim of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, either before or after receipt by the beneficiary." *See* 38 U.S.C. § 5301.

But federal benefits may be garnished or setoff in certain circumstances. 42 U.S.C. § 659 (permitting garnishment for child support and alimony obligations); 31 U.S.C. § 3716 (permitting federal administrative offset notwithstanding § 207); *see also Lockhart v. U.S.*, 546 U.S. 142 (2005) (permitting administrative offset of Social Security benefits to repay defaulted federal student loans).

[2] POMS § GN 02410.001.

[3] *See e.g., Matthews v. Eldridge*, 424 U.S. 319, 332 (1975) (recognizing continued receipt of Social Security disability benefits are property rights protected by the Due Process Clause); *McCahey v. L.P. Investors*, 774 F.3d 543, 550 (2d Cir. 1985) (finding New York's statute requiring notice of garnishment, a "partial list" of exempt funds that included Social Security, and a "prompt opportunity" to be heard on exemptions claims, met Due Process Clause standards); *Finberg v. Sullivan*, 634 F.2d 50, 62-63 (3d Cir.

according to this line of cases, the burden remains on the consumer to raise the protections of section 207.[4] Moreover, we understand that neither the Social Security Administration nor the Department of Veterans Affairs has issued legal opinions that address the relationship between the protections in the federal laws they administer and various state law and state judicial procedural requirements associated with garnishment of protected federal benefits.

There also are important issues under Federal and state law about whether certain types of debt collection practices described above are unlawful. For example, the Fair Debt Collection Practices Act ("FDCPA") prohibits third-party debt collectors from employing deceptive, unfair, or abusive conduct in the collection of consumer debts incurred for personal, family, or household purposes. Creditors are generally exempt when they are collecting their own debts. The FDCPA prohibits making false, deceptive, or misleading representations in connection with collecting a debt; using unfair or unconscionable means to collect any debt; and engaging in conduct that harasses, oppresses, or abuses any person in connection with collecting a debt. It also lists examples of specific prohibited acts or practices that are deceptive, unfair or abusive, but its prohibitions are not limited to these examples.

The Federal Trade Commission and the federal banking agencies may enforce compliance with the FDCPA against the entities over which they, respectively, have

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1980) (finding the garnishment process established by Pennsylvania law, which did not include notice of exemptions or require a prompt hearing, was unconstitutional).

[4] One New York court expressly declined to place the burden on banks to determine whether funds in an attached account include exempt Social Security funds. *See Huggins v. Pataki*, 2002 WL 1732804, *4 (E.D.N.Y 2002) ("[T]he mere fact that banks are now better able to determine that payments are exempt" does not affect the case law precedent. "Perhaps arguments directed to the state legislature will produce a change in the law."). *But cf., Mayers v. New York Comm. Bancorp, Inc.*, 2005 WL 2105810 (E.D.N.Y.) (denying a motion to dismiss a challenge to state garnishment procedures that do not require a bank to determine if an account contains Federal benefits funds before freezing the account.)

jurisdiction; however, the third-party debt collectors whose practices have been highlighted recently are not entities subject to our supervisory jurisdiction. Moreover, the FDCPA *prohibits* the issuance of any regulations by the FTC or the banking agencies to implement its provisions. In light of this inability to specify in regulations the particular practices that violate the FDCPA, and in the absence of legislation, there will continue to be uncertainty about the legality of debt collection practices that have been criticized recently as abusive and unconscionable, such as seeking to attach funds in an account when the debt collector has been put on notice that the account contains solely exempt funds.

What the Federal Banking Agencies Can and Will Do

Notwithstanding the unresolved issues described above, there are actions the OCC and the other Federal banking agencies can and will take to try to alleviate important aspects the problem and hardship described above. But what we can do is by no means a comprehensive solution to the problem.

The OCC and the Federal banking agencies have reviewed the steps we can take, consistent with our respective regulatory and supervisory authority, to address some of the consumer hardships associated with the process of garnishment of Social Security, Veterans' and other specified Federal benefits payments. One step that we can take is to provide supervisory guidance to our regulated institutions concerning these matters.

The OCC and other federal banking agencies are issuing for comment proposed guidance on practices by depository institutions relating to the garnishment process as it affects accounts containing exempt funds. The proposed guidance reflects many of the

same concerns contained the questions posed in the Committee's letter of invitation. Specifically, in order for institutions to minimize the hardship to federal benefits recipients *and* comply with state garnishment orders, the proposed guidance advises institutions to have policies and procedures in place to expedite notice to the customer of the garnishment process and the release of customer funds as quickly as possible. The proposed guidance recommends the following practices:

- Promptly notifying a customer when a bank receives a garnishment order and places a freeze on the customer's account;
- Providing the customer with information about what types of funds are exempt, including SSA and VA benefits, in order to aid the customer in asserting federal protections;
- Promptly determining, as feasible, if an account contains only SSA, VA, or other readily identifiable exempt funds;
- Notifying the creditor, collection agent, or relevant state court that the account contains exempt funds in cases in which the bank is aware that the account contains exempt funds;
- If state law or the court order will permit a freeze not to be imposed if the account is determined to contain only exempt funds, acting accordingly if that determination is made;
- Minimizing the cost to a customer when the customer's account containing SSA or VA benefit funds is frozen;
- Granting the customer access to a portion of the account equivalent to the documented amount of SSA and VA benefits as soon as the institution determines that none of the exceptions to the federal protections against garnishment of SSA, VA, or other exempt funds are triggered by the garnishment order;
- Offering customers segregated accounts that contain only SSA and VA benefits without commingling of other funds; and
- Lifting the freeze on an account as soon as possible in accordance with state law.

The OCC also is taking steps to provide customers of national banks with more information to help understand what their rights, protections, and obligations are with respect to federal benefits and the garnishment process. We have been working with the Financial Management Service of the Treasury Department to develop, in a user-friendly "Questions and Answers" format, consumer information on garnishment of Social Security payments in a deposit account; what a consumer can do if his or her bank account containing Social Security benefits payments is frozen as a result of a garnishment order; and, what a consumer can do if he or she faces repeated garnishment attempts after a debt collector has been notified that the consumer's account contains exclusively protected federal benefits. We will be posting this information to www.helpwithmybank.gov, the financial consumer website sponsored by the OCC, in the very near future.

Need for Legislation and Rulemaking

Even though the Federal banking agencies are taking a number of steps jointly and individually to help minimize consumer hardship in situations involving attempted garnishment of federal benefits, a comprehensive resolution of these issues will be challenging, and will require coordinated action by multiple parties on multiple fronts. No one body, including bank regulators, can fully solve these issues.

As an initial matter, the OCC is encouraged that the Social Security Administration has recognized this complexity and has called for formation of an interagency working group to tackle these issues on a coordinated basis. The OCC looks forward to working with the Social Security Administration and the other participants in

this group to identify areas in which clarification of the law, and enhancement of consumer protections consistent with current law, would be appropriate.

As noted above, however, resolution of these issues could require rulemaking by the Social Security Administration, Department of Veterans Affairs, and other benefit-administering agencies, under their respective statutes, if they conclude that those laws currently provide them sufficient authority in this area. We defer to those agencies to advise the Committee on whether or not they have sufficient authority to address these concerns under existing law. It also is possible that some solutions may require Congress to adopt new legislation.

The issues that need to be addressed include: (1) whether the protections of the Social Security Act, and other federal benefits statutes, against garnishment of federal benefits payments encompass and supersede court-ordered freezes of consumer deposit accounts; (2) whether, and to what extent, those Federal laws impose affirmative duties on parties other than the creditor (or debt collector) and the benefit recipient, to investigate, identify and preserve federal benefit payments from garnishment; (3) whether state laws and procedural requirements that appear to place the burden on consumers to establish to the satisfaction of the courts that funds in their deposit accounts are exempt from garnishment, permit depository institutions not to impose a court-ordered account freeze if the institution can readily determine that the account contains solely exempt funds; (4) whether the Fair Debt Collection Practices Act prohibits particular third-party debt collection practices that have emerged in recent years affecting federal benefits recipients; (5) whether consumers have adequate information about their rights and avenues of legal recourse with respect to garnishment of federal benefits payments, and if

not, how to get it to them; and (6) the impact of responses to these issues on critical government objectives relating to direct deposit of federal benefits payments.

CONCLUSION

In conclusion, Mr. Chairman, and as I summarized at the outset of my statement, there is a very real and meaningful problem, and we must all work to solve it. The Federal banking agencies are addressing the aspects of the issue that are within their respective authorities, but a comprehensive resolution will require action by other key Federal agencies such as the Treasury Department, the Social Security Administration, and the Department of Veterans Affairs, and potentially the Congress and state legislatures. The OCC stands ready to participate in this effort.

Statement of

Montrice Godard Yakimov
Managing Director for Compliance and Consumer Protection
Office of Thrift Supervision

concerning

A Review of Bank Treatment of Social Security Benefits

before the

Committee on Finance
United States Senate

September 20, 2007

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Testimony on
A Review of Bank Treatment of Social Security Benefits
Committee on Finance
United States Senate

September 20, 2007

Montrice Godard Yakimov
Managing Director for Compliance and Supervision
Office of Thrift Supervision

I. Introduction

Good morning Chairman Baucus, Ranking Member Grassley, and Members of the Committee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on issues related to financial institution's treatment of the garnishment of federal benefits.

In my testimony today, I will describe the various types of federal benefits that are exempt from garnishment under federal law. I will also address the efforts of the federal banking agencies (FBAs) to finalize Interagency Guidance on Garnishments to address current issues involving customer accounts that receive federal benefits, and the OTS's advance notice of proposed rulemaking (ANPR) on unfair or deceptive acts or practices. I appreciate the opportunity to appear today on behalf of the Director of the Office of Thrift Supervision and we are most appreciative of the efforts and attention of your staff on the issues we will discuss today.

II. Background

Social Security benefits, Supplemental Security Income benefits, Veterans' benefits, Federal Civil Service retirement benefits, and Federal Railroad retirement benefits often constitute an important part, and sometimes all of an individual's income. Social security recipients are the largest group to receive government payments.[1] According to the Social Security Administration's Master Beneficiary Record from July 2007, over 54 million beneficiaries received Social Security, Supplemental Security Income or both totaling more than $51 billion. Nine out of ten individuals age 65 and older receive Social Security benefits, which represents 41 percent of their total income.

According to the Financial Management Service (FMS), a bureau of the United States Treasury Department, the government mails more than 150 million benefit checks annually, at a cost of about $120 million more than the cost of direct deposit. Today,

[1] As of 6/30/07, the Department of Veterans Affairs reported that 2.8 million veterans received VA benefits (including disability compensation and pension).

about 80 percent of federal benefit payments are made by direct deposit. That means more than 12 million Americans still get their benefit payments through the United States Postal Service. Of these 12 million Americans, FMS estimates that about 4.5 million don't have bank or credit union accounts.

Federal law currently provides that the following types of federal payments are exempt from garnishment:

- Old-Age, Survivors, and Disability Insurance (OASDI) benefits (42 U.S.C. § 407) and Supplemental Security Income (SSI) paid by the Social Security Administration (42 U.S.C. § 1381);
- Veterans benefits paid by the Department of Veterans Affairs (38 U.S.C. § 5301);
- Federal Civil Service pension benefits (5 U.S.C. § 8346); and
- Federal Railroad Retirement benefits (45 U.S.C. § 231m).

These protections from garnishment are subject to certain exceptions, such as garnishment orders relating to alimony or child support payments (42 U.S.C. § 659). In addition, state courts issue garnishment orders and may provide that financial institutions are liable for any funds that are withdrawn by a consumer after the institution has received a garnishment order for a particular account. As a result, financial institutions receiving these orders often freeze accounts until the matter can be resolved by the courts.

The OTS issued guidance to savings associations on the issue of garnishment of federal benefit payments on September 14, 1999. The guidance, OTS Transmittal No.TR-222, involves a Treasury Department notice concerning Electronic Transfer Accounts, or ETA accounts (64 Fed. Reg. 38510). The notice advised institutions that most federal benefit payments deposited to an account at a financial institution are protected from attachment and the claims of judgment creditors by federal law, subject to certain limited exceptions. The notice also informed savings associations of the requirements for ETA accounts including consumer disclosures that covered federal benefit payments are protected from attachment under federal law (again, with limited exceptions such as child support). The Treasury notice was limited to ETA accounts.

III. Industry Practices and Consumer Complaints

Notwithstanding existing federal law that protects certain federal benefits from garnishment, attachment and levy, as noted above, state courts also issue garnishment orders and may impose liability on financial institutions for funds withdrawn by a consumer after an institution receives the order. As a result, financial institutions

frequently freeze accounts upon receipt of a court order to garnish, while they contact their customer and the relevant issues are resolved.

Federal laws that protect federal benefits listed above do not specifically prohibit a financial institution from freezing an individual's account during the period when a garnishment order is challenged by the recipient of the federal benefits. However, the OTS believes that there are best practices that institutions should follow when they receive a garnishment order for a customer that deposits protected federal benefit payments in an account at an institution. Pursuant to this, the FBAs are discussing finalizing proposed interagency guidance for public comment that identifies best practices in this area. Many of the issues included in the draft guidance relate to questions, addressed below, for today's hearing.

While we have received few consumer complaints regarding institution abuses with respect to federally protected benefits, we understand that this is a real concern for many Americans. As such, we will work with the institutions that we regulate to identify and pursue sound best practices in this area.

IV. Solutions and Best Practices

You have asked whether financial institutions should determine, before freezing, attaching, or garnishing an account pursuant to a state court order, whether funds in the account include electronically deposited protected federal benefits. The proposed interagency guidance recently issued by the federal banking agencies for public comment encourages institutions to determine, as feasible, if an account contains only exempt federal benefit funds, such as Social Security or Veterans benefits. We have solicited comment on this practice and will carefully consider all comments received on the issue.

You also ask whether financial institutions should be allowed to charge fees against protected federal benefits electronically deposited in a bank account that has been frozen, attached or garnished. Specifically, you ask about fees for implementing an account freeze, attachment or garnishment; for restoring frozen funds; or for returning checks or debits because there are insufficient funds in the account resulting from the freeze, attachment or garnishment. The proposed interagency guidance indicates that it is a best practice to minimize the cost to a consumer when an account containing exempt federal benefit funds is frozen. This would involve, for example, refraining from imposing overdraft, NSF, or similar fees while the account is frozen or refunding such fees when a freeze has been lifted. We will carefully consider all comments received on the issue.

Finally, you inquire whether the OTS has the authority to issue guidance and/or regulations that would require banks to identify funds protected by Federal law and exempt those funds from a freeze and subsequent garnishment or attachment, rather than relying on the account holder to seek such protection in court.

The FBAs have authority to provide guidance to the institutions we regulate regarding supervisory expectations relating to compliance with federal law or regulations. The proposed guidance on garnishments is an example of our authority in this area. The OTS stands ready to work with the other FBAs and with other federal authorities responsible for the provision of the various protected federal benefits to provide greater clarity to the institutions we regulate regarding practices such as account freezes and related fees. These issues impact millions of Americans, including those with modest incomes who rely heavily on their federal benefits. OTS is committed to ensuring that customers of the nation's savings associations receive the protections intended by federal law.

Pursuant to the proposed interagency guidance, several best practices address the issue of identifying federally protected funds and exempting those funds from a freeze and subsequent garnishment or attachment. These practices include:

- Prompt notification to the creditor, collection agent, or relevant state court that the account contains exempt funds in cases in which the financial institution is aware that the account contains exempt funds.
- Exercising flexibility to avoid placing a freeze on an account that contains only exempt funds if that is permitted by state law or court order.
- Allowing consumers access to a portion of the account equivalent to the documented amount of exempt federal benefit funds as soon as the financial institution determines that none of the exceptions to the federal protections against garnishment of exempt federal benefit funds are triggered by the garnishment order.
- Lifting the freeze on an account as soon as permissible under state law.

The federal banking agencies are aware of the hardship that recipients of exempt federal benefit funds may face when a freeze is placed on their accounts. Proposed interagency guidance issued by the FBAs would minimize the hardship by encouraging institutions to have policies and procedures in place to address garnishment orders. This includes procedures designed to expedite notice to the consumer of the garnishment process and release funds to the consumer as quickly as possible. Toward that end, the proposed guidance encourages institutions to:

- provide the consumer with information about what types of federal benefits are exempt, including Social Security Act and Veterans benefits, in order to aid the consumer in asserting federal protections; and
- offer consumers segregated accounts that contain only federal benefits funds without commingling of other funds.

Again, we are soliciting comment on these practices pursuant to the proposed interagency guidance.

V. OTS Proposed Rulemaking on Unfair or Deceptive Acts or Practices

While the proposed Interagency Statement on Garnishment currently under review would address best practices, the OTS is also addressing related issues on a separate track. On August 6, 2007, OTS issued an ANPR on Unfair or Deceptive Acts or Practices (72 FR 43570). The ANPR solicits comment on a wide variety of acts or practices that the OTS could consider prohibiting as unfair or deceptive under section 5 of the Federal Trade Commission (FTC) Act. These include issues relating to the practice of freezing accounts upon receipt of court orders to garnish an account. The comment period on the ANPR ends November 5, 2007.

Pursuant to the ANPR, the OTS solicits comment on whether we should use our authority to promulgate rules under the FTC Act and the Home Owners' Loan Act to issue additional UDAP rules; identifies existing prohibited practices; solicits input on various approaches the OTS could consider in a UDAP rule, including the FTC approach, approaches taken by various states through anti-predatory lending laws, and various models other federal agencies have taken to define and prohibit unfair or abusive lending practices. The ANPR also solicits comment on the principles the OTS should consider in determining whether a product or practice is unfair or deceptive and whether the agency should consider various practices unfair or deceptive.

Finally, we recognize that the financial services industry and consumers benefit from consistent rules and guidance in the oversight of similar areas and activities. The FBAs have adopted uniform or similar rules in many areas, and we hope to solicit comment in the ANPR regarding the application of consistent interagency UDAP standards among the FBAs. We believe the comments we receive will be helpful as OTS reviews this important issue. We plan to share comments on this subject and all others we receive in connection with the ANPR with the other FBAs toward the goal of interagency consistency.

VI. Conclusion and Recommendations

The OTS is aware that there are many Americans who heavily rely upon federal benefit payments as their primary or sole source of income. OTS is committed to working with policy makers, consumer advocacy organizations, the federal agencies responsible for administering protected benefit payments, the banking industry, and others on this important issue. Clear statutory requirements and communication of

supervisory expectations from the banking agencies help to ensure that federal consumer protections on garnishments and related practices are followed and fully implemented.

To achieve this objective, the OTS strongly supports continued discussion by the appropriate federal banking agencies and clear interpretations by responsible federal agencies that administer protected federal benefits on interpreting statutes that preclude garnishments, levies and attachments. OTS also recommends that policy makers reach out to affected parties to consider whether to undertake legislation that would provide financial institutions with protections from liability for failing to comply with a state court order, provided the institution acted responsibly under the affected statutes when trying to maximize access to funds for individuals who receive protected benefits.

The OTS is aware that compliance with prohibitions in the Social Security Act and other federal benefits can be challenging for financial institutions. There are many nuances to the application of existing precedent and exceptions to the garnishment of federal benefits. We are hopeful that the comments we receive in response to the proposed interagency guidance and in conjunction with our pending ANPR may provide useful information to policymakers and regulators in this area. Please be assured that Director Reich and OTS stand ready to discuss challenges, address questions and identify steps that policymakers and regulators can take to address this important consumer protection issue.

Thank you, Mr. Chairman, Ranking Member Grassley, and Members of the Committee for the opportunity to present the views of the OTS. I look forward to your questions.

September 19, 2007

The Honorable Charles E. Grassley
Senate Finance Committee
219 Senate Dirksen Office Bldg.
Washington, DC 20510

Dear Senator Grassley:

AARP and its 39 million members commend you for convening this hearing on the freezing of bank accounts containing Social Security benefits. Given Social Security's critical role in the economic security of beneficiaries, it is clear that bank garnishment of government benefit payments, which is already prohibited by law, can be a serious and unnecessary threat to the health and well-being of millions.

AARP has had a long-standing interest in protecting beneficiaries against garnishment of their Social Security checks.[1] This is particularly critical for the millions of beneficiaries who rely almost exclusively on Social Security for income. About twenty percent of elderly Social Security beneficiaries rely on their monthly benefit payment as their sole source of income. For almost one in three beneficiaries, Social Security represents 90 percent or more of their total income.

Current law for Social Security is clear:

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.[2]

Despite the clear prohibition in the law, many financial institutions have chosen to freeze accounts that are funded exclusively with protected funds. In the District of Columbia alone, the AARP Legal Counsel for the Elderly receives upwards of 100 potential cases each year on this issue.

[1] In addition to our advocacy efforts on Capitol Hill, AARP attorneys have filed amicus briefs in Lopez v. Washington Mutual Bank, Inc. and Miller v. Bank of America.
[2] 42 USC § 407 (a)

The federal government has made a concerted effort to encourage beneficiaries' use of direct deposit. The Social Security Administration (SSA) actively promotes direct deposit as "safe, quick and convenient."[3] SSA tells beneficiaries:

> When you use Direct Deposit, you can rest assured that your money is safe. Since your money goes directly into the bank in the form of an electronic transfer, there's no risk of a check being lost or stolen. In fact, since 1976 when Direct Deposit first became available to Social Security beneficiaries, not one payment has ever been lost.[4]

AARP agrees that direct deposit is the preferred method of receiving benefit payments. It is inherently safe, and beneficiaries have access to their money more expeditiously.

Unfortunately, bank garnishment of funds runs counter to the desire to promote direct deposit. The problem occurs when banks, responding to a court order of debt collection, garnish funds that are otherwise exempt from garnishment, setting into motion a series of events that can have catastrophic results. Once an account containing exempt funds is garnished, a beneficiary or their advocate must contact the creditor in order to get the funds released. Banks then charge "processing fees" for the garnishment action (often $100). During the freeze, the beneficiary does not have access to his or her money, and may be further accumulating bounced check and overdraft fees (typically $30 or more per occurrence). At the same time, affected individuals could be forced to decide between food, shelter and medical needs because their money is not accessible.

We need to honor the promise we make to those who choose direct deposit that their funds will be safe and available when they need them. Negative consequences could be avoided if banks would more carefully monitor account activity, such as identifying accounts whose primary source of deposit over a period of time are direct deposits from a government agency, and actively protect their customers' accounts from improper garnishment. While some banks currently do just that, all banks owe it to their customers – the account holders – to protect all funds that are exempt from garnishment, rather than accede to creditors without verifying the source of account deposits.

We urge Congress and the Administration to ensure enforcement of current law, resolve the uncertainty and protect the interests of beneficiaries, and to do so without delay.

Sincerely,

David P. Sloane
Senior Managing Director
Government Relations and Advocacy

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[3] http://www.socialsecurity.gov/deposit/, accessed 9/19/07
[4] http://www.socialsecurity.gov/deposit/safe.htm, accessed 9/19/07

Statement for the Record

of the

AMERICAN **BANKERS** ASSOCIATION

Committee on Finance

United States Senate

For the hearing

Frozen Out: A Review of Bank Treatment of Social Security Benefits

September 20, 2007

American Bankers Association, 1120 Connecticut Avenue NW, Washington, DC 20036

Mr. Chairman and members of the Committee, this statement is being submitted for the record by the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country. ABA appreciates the opportunity to submit this statement for the record regarding exemption of Social Security and other federal or state benefits from valid garnishment orders issued by a court of law.

The world in which we live has changed in the last decade, especially with respect to the delivery of financial products and services. The advent of direct deposit, electronic fund transfers, and automated clearing house transactions, etc. has not only drastically changed how banks operate, but also has enhanced the way in which the federal government and other payors make payments to beneficiaries and annuitants. The law, however, has in some instances lagged behind this remarkable expansion of banking services. Today's hearing has been prompted by news accounts of the unfortunate (and, ABA believes, isolated) stories of bank customers who have been unable to access their government benefits after creditors have obtained court orders garnishing their bank accounts.

Congress has already taken steps to protect individuals who receive Social Security benefits. It is important to both the customer and the bank that the government provide an answer to the question of how to determine when those provisions apply and, more specifically, whether it is the bank, the court, or the customer who should be the one to determine whether funds deposited into an account are exempt from garnishment. The lack of a clear answer to this question generally creates a functional gap between federal and state law which, to borrow a phrase, can put a financial institution between a rock and a hard place.

Since the beginning of this decade, the federal government (and the Social Security Administration (SSA) in particular) has encouraged all Americans to have their Social Security and other benefits directly deposited into bank accounts rather than continue to receive paper checks via the mail. This effort was embarked upon for several reasons, mostly to cut costs to the federal government and to expedite the transfer of funds to beneficiaries. Furthermore, the Federal Reserve and the Treasury Department (Treasury) have undertaken efforts to encourage all Americans to have a bank account with an insured depository institution. Banks have responded to this effort by providing a variety of account types that feature different products, including low cost and even no cost accounts, and also, accounts that are geared towards people who receive government benefits and people on a fixed income. Many of the simple or "no frills" accounts offer customers the chance to have access to the traditional services and safety of a bank at a very low or no cost. In addition to helping fulfill the SSA and Treasury's goal of increasing the number of Americans with bank accounts, the availability of these types of accounts has made it easier for more Americans to stop the practice of keeping their savings under their mattress or to stop using a check cashing business to process their check. Notwithstanding the type of account that a customer chooses, the bank typically would assess service charges for any non-standard services that are provided for the account. Therefore, like any other bank customers, if the accountholder in one of these "no frills" accounts requires additional services not covered by the account, the institution may need to charge fees in order to cover the costs of the services provided to the customer.

Now, imagine you are a community banker who has a customer who maintains a regular checking account at the bank. One day you receive an order from the court to garnish the customer's account to satisfy a judgment. The first and perhaps the most important question the bank has to wrestle with is whether the funds are statutorily exempt from garnishment. One assumes that (1) the customer would be aware of the judgment against him or her, and (2) as owner of the account, the customer could inform the bank that the funds in the account are exempt from garnishment. Indeed, some customers do this. Nevertheless, most banks receiving a garnishment order will conduct some due diligence before obeying the order. Although this sounds simple, this involves numerous steps that must be taken in order to ensure that both the customer and the lien holder are being treated appropriately.

The simplest scenario is one in which the account is maintained only for Social Security benefits and has only ever had deposits from Social Security –the bank generally may not garnish funds in that account. The more complex situation arises in which the account contains (or is maintained for) both Social Security benefits and other funds (mixed funds account). The law is not clear on what the bank is required to do, and the lack of clarity puts the bank in a difficult situation that has no easy solutions. If the bank receives a court order for garnishment on an account that has these mixed funds, the bank typically has several options on how to address the situation, all of which pose further questions. The options are:

1. Accept the court order and make a decision to garnish the account. This can result in violating state/federal law, because Social Security benefits can not be used to offset a judgment.

2. Not obey the court order, because there is no easy way to differentiate between which funds in the account are Social Security benefits and which are other funds (money is fungible). This could result in the bank being in contempt of court and subject to penalties.

3. Place a hold on the account (i.e., freeze the account) until all the parties involved are able to resolve the issue. This situation requires the bank to expend time and money to mediate in a situation in which it is a third party, only trying to comply with the law. No bank wants to be in a situation in which it is caught between its customer, the court, and the state/federal government.

Unfortunately, however, the third option is usually the one most used by banks. This allows a bank to avoid being in violation of both the court order and state/federal law. Banks generally try to avoid being in an adversarial position with their customers. However, this issue creates a situation in which the bank has to freeze the customer's account and assess charges that result from services provided due to the situation, thereby pitting the customer against the bank.

Much like consumers, banks would like to find a solution to this problem. ABA would like to work with Treasury, the SSA, the financial regulators, and Congress to find a reasonable solution.

As the discussion on how to resolve this matter continues, ABA believes that the solution must strike the proper balance between providing protection to consumers, while not creating a disincentive for banks to offer accounts to those who receive government benefits.

We would like to thank the committee for holding this hearing and giving us the opportunity to comment. Additionally, we look forward to working with you on these and other issues during the 110th Congress.

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