Statement of
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on the
Impact of Garnishment on Social Security Benefits
before the
Committee on Finance; U.S. Senate
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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 In many states, financial institutions are potentially liable for any funds withdrawn by a debtor from an account after a freeze or hold has been placed upon it pursuant to a court garnishment order.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 decision2 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 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 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.

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)

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

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