TESTIMONY FOR THE SUBCOMMITTEE

OF THE

SOCIAL SECURITY

OF THE

HOUSE WAYS AND MEANS COMMITTEE

ON

PROTECTING SOCIAL SECURITY BENEFICIARIES FROM PREDATORY LENDING AND OTHER HARMFUL FINANCIAL INSTITUTION PRACTICES

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AARP appreciates the opportunity to present its views on how certain payday lending and other financial institution practices may harm vulnerable Social Security beneficiaries and may undermine the intent of the Social Security Act. We commend the committee for its bipartisan interest in an issue that affects the peace of mind of millions of older Americans. Given Social Security's indisputable role in the economic security of millions of vulnerable beneficiaries, it is clear that such financial practices must be curtailed so that Social Security beneficiaries always receive their full benefit under the law.

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice, and control in ways that are beneficial and affordable to them and society as a whole. We produce AARP The Magazine, **AARP Bulletin**, AARP Segunda Juventud, NRTA Live and Learn, and provide information via our website, www.aarp.org. AARP publications reach more households then any other publication in the United States.

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 their income. About twenty percent of Social Security beneficiaries age 65 and older rely on their monthly benefit payment as their sole source of income. For almost one in three beneficiaries, Social Security represents at least 90 percent of their 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. In other instances, payday lenders and check cashing businesses have co-opted certain processes -- the so-called "master/sub account arrangement," which is intended for the convenience and benefit of the Social Security recipient. Many payday lenders and check cashers are instead using these arrangements to trap Social Security beneficiaries in an endless cycle of greater debt and obligation. Similar concerns with these predatory practices have been noted elsewhere in the federal government. Several years ago, at the request and with the strong support of the Department of Defense, Congress passed -- as part of the John Warner Defense Authorization Act -- the Talent Amendment, which placed strong restrictions on the

[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)

ability of payday lenders to prey upon our service men and women. Social Security beneficiaries deserve nothing less.

Bank Garnishment of Bank Accounts with Exempt Federal Funds

Although some banks already have policies and procedures in place to protect exempt funds from garnishment, many others have not developed similar procedures. AARP believes all banks, preferably voluntarily but through legislation and/or regulation if necessary, should implement safeguards for customers whose accounts contain exempt funds. Additionally, the imposition of fees and penalties resulting from the garnishment is an unfair practice that should be suspended. AARP believes that banks can utilize the technology and policies already in place to protect exempt funds from garnishment.

Currently, there is no consistent approach to addressing the issue of garnishing exempt federal funds. The process for garnishing funds is established by state law and generally funds may not be seized absent a court order. Although it is well established that Social Security benefits, Supplemental Security Income (SSI) benefits, Veterans' benefits, and Railroad Retirement benefits are protected against garnishment, once those benefits are commingled with nonexempt funds, exempt funds are sometimes inadvertently garnished. California, Pennsylvania, New York, and Connecticut all have laws addressing the garnishment of federally protected funds. Under Pennsylvania's law, it is impermissible to garnish any bank account holding both exempt and non-exempt funds.[3] California, New York, and Connecticut limit the amount of funds that can be garnished from an account holding both exempt and nonexempt funds by establishing a threshold amount below which garnishment is prohibited. New York's law goes further by extending protection to banks that fail to comply with a garnishment order on the grounds that the funds in the bank account are exempt.[4]

It is difficult to accept the argument that the application of garnishment exemptions to commingled funds is a burdensome task when existing banking procedures can be used to identify the source of the funds. Under existing banking procedures, all direct deposits are electronically tagged to identify the source of the deposit. In other words, deposits consisting solely of federally exempt funds are easily identifiable because the source of the deposit is clearly marked. Additionally, federal benefit payments increase only once a year and the same amount is deposited each month to a recipient's account. If banks review the record of deposits to the account over the course of 90 days, they can easily identify which accounts contain only exempt funds as those deposits are usually made once a month and are designated as federal funds.

While banks argue that they are faced with legal repercussions for rejecting garnishment claims, instances of banks incurring liabilities for failure to comply with garnishment orders because funds were exempt are nonexistent. In fact, courts have held banks liable when a bank has ignored clear evidence of the exempt status and also in instances when a bank has failed to release funds even after the customer presented proof of exempt

[3] 231 PA Code Ch. 3000, Rule 3111.1.
[4] 1 New York Civil Practice: CPLR P 5251.14.

status.[5] Federal law is clear that exempt funds cannot be garnished.[6] Although banks may fear reprisal from a state court for failure to comply with a garnishment order, federal law preempts any state-based directive requiring garnishment of exempt funds. In addition to requiring the banks to be more proactive upon receipt of a garnishment order in determining whether funds are exempt, agencies should consider whether regulations or additional guidance are needed to provide clearer authority for banks to rely upon when rejecting a garnishment order.

Although some banks maintain that it is too onerous to differentiate between exempt funds and nonexempt funds, other banks are able to identify those accounts containing exempt funds and reject garnishment claims. Currently, several banks have procedures in place to protect customers who have exempt funds directly deposited into their accounts. New York Community Bank, Astoria Federal Savings, Roslyn Savings Bank, and JP Morgan Chase 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."[7] Banco Popular, a bank based in Puerto Rico with U.S. and Caribbean operations, will reject a garnishment order if account deposits for the past 90 days are entirely comprised of exempt funds. Upon discovery of commingled exempt and nonexempt funds, Banco Popular notifies the creditor. This practice of reviewing accounts to determine the source of deposits and identifying those that contain only exempt funds should be the standard practice for all banks.

Another option is to require banks to offer separate bank accounts that are primarily for exempt fund deposits with no commingling of funds from other sources. For example, Astoria Federal Savings offers a checking account designed specifically for individuals over the age of 50 without charging a monthly fee. Requiring banks to offer accounts that are solely for the deposit of federal benefit payments will make it easier for banks to segregate funds.

After a bank account has been frozen, the account holder is unable to write checks or withdraw money from the account. There are no other means of providing recipients with access to their exempt funds during the garnishment process other than canceling direct deposit and requesting paper checks.

Although most states require that bank holders be notified after their accounts have been frozen, recipients of exempt funds usually are not aware of the exceptions to garnishment. In fact, most recipients are unaware even at the time they begin receiving benefits that their benefits are exempt from garnishment. It is only after the account has been frozen that recipients learn that they can file a claim with a debt collector to have

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[5] *Chung v. Bank of America*, 2004 WL 1938272 (Cal. Ct. App. 2004) (unpublished) (stating that bank garnishee had duty to verify whether funds were exempt, not creditor); *Lukaksik v. Bank North*, 2005 WL 1219755 (Conn. Super. Ct. Apr. 26, 2005) (plaintiff pleaded exceptional circumstances sufficient to maintain action for breach of fiduciary duty).

[6] 42 U.S.C. § 407.

[7] Margot Saunders, National Consumer Law Center, Testimony before the Senate Committee on Finance, (Sept. 20, 2007).

those funds that are Social Security benefits, SSI benefits, Veterans' benefits, and Railroad Retirement benefits exempted from garnishment. Federal law is silent on who is responsible for informing recipients that their funds are exempt from garnishment. For example, the Social Security Administration's (SSA) website fails to educate recipients of the exemptions that are available to protect their benefits. Unfortunately, those who learn about the notice and opportunity to seek exemption from garnishment do so only after they have suffered financial hardship.

Although the federal government is responsible for distributing benefits, banks can do their part by informing account holders that their funds are exempt from garnishment. For example, if a bank requires individuals to use separate accounts for the deposit of their benefits, at the time the account is opened the bank should inform the recipient the funds are protected from garnishment. Banks can also provide a notice on the monthly bank statement for those customers receiving exempt federal benefits advising them of the exempt status of their benefits.

Generally, the cost to account holders for freezing a bank account ranges from $100 to $175. Once an account is frozen, insufficient funds fees range from $25 to $39 dollars per check or transaction presented for payment. It can be quite lucrative for a bank to freeze an account. Typically, after an account is frozen, checks written prior to an account holder's knowledge of the freeze are returned for insufficient funds. These fees can dramatically reduce or wipe out an individual's benefits. Losing benefits to cover bank fees is a common occurrence and is a matter of serious concern. Currently, it is standard practice in the banking industry to apply incoming deposits against outstanding overdrafts regardless of the source of the funds. AARP urges that banks be prohibited from assessing overdraft and other punitive fees against accounts consisting entirely of exempt federal funds.

Another alternative could be to declare the assessment of fees against accounts containing only exempt funds an unfair trade or business practice. In 2006, banks earned approximately $17.5 billion dollars from fees assessed against customers who had insufficient funds in their bank accounts. Typically, the bank receives the garnishment order, freezes the bank account, and then notifies the customer of the freeze or hold on the account. Usually the customer has already written checks in good faith prior to receiving notification of the account freeze. Although it is well settled that banks may impose fees for legitimate non-garnishment related items that create an insufficient funds balance in an account, it is unfair for a bank to charge customers penalties and fees for an insufficient funds balance triggered by an improper garnishment. This is especially harsh for those whose federal benefits are their sole source of income. Debt collectors who pursue bank accounts that contain exempt federal funds should be required to reimburse the bank or bank account holder for any freeze or insufficient funds fees charged to the account. Banks or debt collectors should also be required to reimburse beneficiaries for the insufficient fund fees after it has been determined that those fees were incorrectly imposed against an account containing exempt federal funds.

Federal agencies regulating the banking industry can and should do more to protect individuals depending upon federal benefits by requiring banks to implement procedures

that safeguard exempt federal funds. Although the federal government is primarily responsible for ensuring that exempt funds are protected, it should be noted that states play an important role in the garnishment process and should be encouraged to revisit their policies on this issue.

It is unacceptable for some banks to argue that implementing safeguards or policies to protect exempt federal funds would be costly or time-consuming when other banks have already put mechanisms in place to prevent the garnishment of exempt federal funds. This argument is further diminished inasmuch as the technology and tools to segregate funds are widely available to protect exempt funds with little or no additional cost to banks. With 48 million recipients opting to receive their benefits via direct deposit, and efforts to mandate direct deposit as the sole means of receiving benefits for future recipients, the need to address the garnishment issue is urgent.

Last year federal banking regulators asked for comments on "best practices" it proposed as guidance to banks for avoiding the garnishment of exempt federal funds. While guidance and best practices are useful in that they publicize procedures banks could adopt, AARP believes the banking regulators should issue regulations that require banks to protect federal benefits from any garnishment, attachment, or other circumstance that denies access to funds that are, by law, protected for the use of the individual.

We understand that the bank regulators are close to an agreement on a solution that would protect a certain level of exempt funds from garnishment. This is an important step, and AARP looks forward to learning more about the proposal and the opportunity to comment on it.

The Improper Use of Master/Sub Account Arrangements

The Social Security Administration recently asked for comments on the use of master/sub account arrangements for receiving benefits. SSA has allowed the use of master/sub accounts in the past, primarily as a convenience to the beneficiary. Nursing home residents (who are required to contribute their monthly benefit to the cost of their care, minus a small personal stipend, if they are Medicaid recipients), members of certain religious orders (who have taken vows of poverty) and investment accounts with a regulated brokerage firm are the noted examples. There is no reason to believe these uses have proven harmful to the individual or that there is a need to discontinue master/sub account arrangements that work to the benefit of those receiving Social Security.

The agency noted its concern that these arrangements have become a preferred method for payday lenders and check cashing businesses to gain access to benefits in order to produce revenue from fees for services or to guarantee repayment of single-installment loans. In our comments, we urged the agency to adopt rules that detail the circumstances under which a master/sub account arrangement is appropriate. The agency could stipulate that depositing a benefit check into an account held primarily by someone other than the beneficiary is allowable when the account holder has been appointed by SSA as the representative payee. This well-known and successful program could easily be

applied to the situations (like nursing homes and religious orders) for which the current process was intended.

Alternatively, the agency could stipulate that master/sub accounts are appropriate only when the account is with an institution that is subject to federal regulatory oversight. While such a requirement would not necessarily prevent some abusive practices by payday lenders and check cashing outlets (for example, making a loan or service contingent on opening an account with a specific depository institution – a practice that is already prohibited by statute and regulation), it would provide an opportunity for greater regulatory scrutiny.

While it may not be feasible or desirable to eliminate master/sub arrangements altogether, SSA could further clarify when they are appropriate by identifying the relationships between the parties that must exist before the arrangements will be approved. The agency could stipulate the holder of a master account must be:

- A registered broker/dealer, as that term is defined by Securities Exchange Act of 1934;
- Any relationship in which the master account holder has a fiduciary obligation to the proposed sub account holder; or
- A designated representative payee.

Moreover, a master and sub account arrangement should be prohibited if an institution seeks to condition the extension of credit on the direct deposit of federally exempt benefits. This arrangement violates the credit laws and the laws relating to assignment of such funds.

Our hope is that SSA will move forward with strong regulations that ensure master/sub account arrangements are utilized only when necessary and appropriate.

Direct Deposit as a possible solution

The federal government has made a concerted effort to encourage beneficiaries' use of direct deposit. The Social Security Administration actively promotes direct deposit as "safe, quick and convenient."[8] 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.[9]

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

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

honor the promise we make to those who choose direct deposit that their funds will be safe and available when they need them.

The Treasury Department recently launched an alternative means to receiving Social Security benefits for those without a bank account. The Direct Express debit card offers the possibility of receiving benefits without resorting to other costly methods of converting checks into cash or cash equivalents. In addition, since these accounts have only exempt federal benefits in them, there can be no question that these accounts cannot be garnished by court order or hijacked by an improper master/sub account arrangement. The Direct Express debit card allows the unbanked (those most likely to use the services of a check cashing service) to utilize the safe and secure direct deposit method and holds promise for helping reduce the identified potential for fraud and abuse. AARP supports SSA's efforts to encourage, but not require, the use of Direct Express.

Conclusion

Market conduct, such as illegal garnishment or improper use of master/sub account arrangements, that serves to deny beneficiaries the full access, control, and use of their benefit payments is of great concern to AARP. We are committed to pursuing a solution to these problems and to educating the public on how to avoid circumstances that might lead to having someone else access their benefits. To that end, our **AARP Bulletin** recently set up an e-mail clearinghouse to hear the personal stories of those who have been victim of the practices described above. With guarantees of anonymity anyone – victims, family, advocates – can share their stories by sending an email message to paydayscams@aarp.org. Our hope is that by demonstrating -- with real people and real circumstances -- what can and does happen we will help consumers be more market savvy and help guide policymakers to a solution that provides greater economic security to Social Security beneficiaries.