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

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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C O N T E N T S

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

TUESDAY, JUNE 24, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:00 a.m., in room B–318, Rayburn House Office Building, the Honorable Earl Pomeroy presiding.

[The advisory of the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–39439
May 03, 2007
HL–9

Subcommittee on Social Security Chairman McNulty Announces a Hearing on Protecting Social Security Beneficiaries From Predatory Lending and Other Harmful Financial Institution Practices

Congressman Michael R. McNulty (D–NY), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine 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. **The hearing will take place on Tuesday, June 24, 2008, in room B–318 Rayburn House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

Because Social Security and Supplemental Security Income (SSI) benefits are intended to provide basic income, the Social Security Act contains special provisions to protect these benefits from creditors in order to ensure that funds are available for food, clothing and shelter. Social Security Act Section 207 (42 U.S.C. 407) states that the right of an individual to any future benefit payment "shall not be transferable or assignable," and that none of the benefits "shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law." (There are limited exceptions for alimony, child support, and federal debts.)

However, a number of financial institution practices have come to light which may undermine the intent of these protections:

- Banks and credit unions may place a freeze on a beneficiary's bank account in response to a court order issued on behalf of creditors or debt collectors seeking to garnish the assets in the account.
- Some banks accept "direct deposits" of Social Security benefits which are then distributed to the beneficiary only through a check-cashing store, with multiple fees charged by the bank as well as the check-cashing store. These "direct-deposit accounts" offer none of the other features of a typical bank account, such as the ability to write checks against the account or use an ATM card.
- Payday lenders and others who steer beneficiaries into such direct deposit arrangements with banks may offer short-term, high-interest loans to beneficiaries, secured by their monthly check. Fees, interest and payments for the loan are then deducted through automatic withdrawals before the beneficiary ever has access to his or her benefits. As a result, beneficiaries often lose control over their monthly check.

The news media and consumer advocates have described how freezing of accounts by banks on behalf of creditors has harmed beneficiaries. Other reports have revealed that certain lenders and check-cashing operations may be targeting vulnerable Social Security and SSI beneficiaries, assessing needless fees for direct deposit arrangements and potentially exerting undue control over a beneficiary's monthly check. Moreover, the Social Security Administration (SSA), Treasury and the bank regulating agencies have been contemplating a number of policy changes in response to these problems.

In announcing the hearing, Chairman McNulty stated **"The Social Security Act explicitly protects Social Security benefits from certain debt collection procedures and prohibits assignment of benefits to third parties. Yet, certain financial practices may undermine these protections. Beneficiaries should not lose control over how their funds are spent simply because they lack bank accounts and are steered into abusive direct deposit arrangements. Nor should seniors and people with disabilities be required to navigate through complex legal channels in order to ensure that benefit protections are enforced. We owe it to our most vulnerable citizens to ensure that the Social Security Act's protections are observed by financial institutions."**

FOCUS OF THE HEARING:

The hearing will examine certain financial practices of banks and other institutions regarding account freezes, garnishment of beneficiary accounts, and high-fee direct deposit arrangements with certain payday lenders and check-cashing businesses. It will also evaluate how these practices may conflict with benefit protections in the Social Security Act, examine the response of SSA and federal agencies that regulate financial institution practices, and consider whether further action is required.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov,* select "110th Congress" from the menu entitled, "Committee Hearings" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Follow the online instructions, completing all informational forms and clicking "submit" on the final page. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Tuesday, July 8, 2008**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Mr. POMEROY [presiding]. The Subcommittee will come to order. Chairman McNulty asked that I preside over today's hearing, as he is unable to attend, due to a family illness. I understand that Sam Johnson, Ranking Member, also dealing with a family illness today. Our thoughts are with the families of each of them. Due to the urgency of the subject matter, Chairman McNulty asked that this hearing move forward, and has, therefore, asked me to Chair it.

We are going to look at today how certain banking, debt collection, and lending practices may undermine provisions of the Social Security Act intended to protect beneficiaries' basic income. We are concerned that these practices have the potential to harm vulnerable beneficiaries.

So, the thrust of our hearing, I think, is going to be twofold: looking at the problem, and basically ascertaining what I think is broad agreement about the problem; and then looking at the absence of a Federal response, and trying to get to the bottom of where a response is. If there is an agreement there is a problem, why isn't a response in place? I think those will be the twin barrels of our inquiry today.

The Social Security Act contains special provisions protecting Social Security and SSI benefits from creditors, in order to ensure that funds are available for basic needs, such as food, clothing, and shelter. Section 207 of the Social Security Act generally protects benefits from garnishment, assignment, and other legal proceedings related to collection of debt.

However, a number of financial practices have come to light which undermine these practices—or these protections, rather. These practices include freezes on beneficiary bank accounts, garnishments, high fee direct deposit arrangements, and payday lending to unbanked Social Security beneficiaries.

What really puts this into focus as an important issue to vulnerable beneficiaries is the fact that the average Social Security monthly benefit is $990; for SSI, it's $477. The testimony today is going to show that fees to access these benefits from check cashing stores can add up to as much as three percent of the total benefits. Bank fees related to bank freezes can reach $175, and additional bounced check fees can reach $40.

We consider that Social Security provides more than half of the monthly income for 54 percent of senior couple, 74 percent of the non-married seniors, and the Social Security check is the only income for 29 percent of non-married seniors, these fees represent a significant portion of funds intended to provide for basic needs.

As I mentioned, there is a general consensus among the relevant Federal agencies and Consumer Protection Act advocates that these practices present a problem, and they should be addressed. However, it's been a long, slow road to nowhere, in my view, in terms of getting the kind of action that people have the right to expect.

In 1996, the EFT–99 law was enacted, which mandates that Federal payments be made electronically by 1999. Many of the problems we're seeing today were actually foreseeable back to the 1996 legislation, some of which discussed as late as the 1990s.

In April of 2007, the Wall Street Journal reports on debt collectors garnishing bank accounts with Federally protected funds and bank freezing accounts, and charging fees, even though the funds in those accounts are protected under the Social Security Act.

The Committee on Financial Services Chairman, Barney Frank, sends a letter in June of 2007, requesting better oversight on banks' compliance with the Social Security Act, and asking for information from FDIC in return.

August 2007, Senate Finance Committee sends a letter. The— August 2007, FDIC Chairman Blair proposes a Federal financial institute examination council task force. August of 2007, SSA Commissioner Astrue asks OMB to conduct a multi-agency process to issue a rule to protect Federal benefits from creditors.

August of 2007, FDIC issues information to banks about Section 207, the section holding these funds exempt, but public comments indicate that clear rules on how banks should treat benefits are necessary.

September 2007, Senate Finance Committee holds a hearing. November 2007, Senate Finance Committee sends a letter to OMB, strongly supporting Astrue's request for multi-agency rule-making. November 2007, close of 60-day comment on the FDIC notice.

Early 2008, pursuant to the FDIC statement, bank agencies, benefit payment agencies met with banks and consumer groups. May 2008, Treasury staff brief Senate finance, House Ways and Means and Senate Special Committee on Aging on progress on interagency rule-making where the policy in the potential rule was described, but no time line for rule-making or implementation proposed.

June of 2008, House Ways and Means staff asks for information on when rule-making can be expected, and are told that discussions between Treasury, banking agencies, and SSA are still needed.

So, again, I think, while the first panel will be extremely valuable to the Committee in putting on the record the underlying problem, which really isn't in dispute, between any of the related Agencies—or, for that matter, as far as I know, Members of Congress overseeing this matter—the second panel will perhaps bring us information about why we don't have resolution yet, in terms of a Federal response.

I view this hearing as a classic case of pretty clear issue, pretty clear need for a response, no response forthcoming. Here we're going to try to get to the bottom of what are we waiting for.

So, with that, I would turn to my Ranking Member of the day, for his statement. Thank you.

Mr. BRADY. Thank you, Chairman Pomeroy, for holding the hearing today. I am, as well, pinch-hitting for Sam Johnson, Ranking Member on the Subcommittee on Social Security. With your permission, I would like to read his statement into the record.

Those of us who have the privilege of serving on this Subcommittee are especially aware of the vital income support that Social Security provides, especially those who are most vulnerable. Social Security is the only source of income for one in four of our seniors. To prevent debt collectors from depriving beneficiaries of the funds they need for their daily living expenses, the Social Security Act prohibits the taking of Social Security benefits to collect debts, with few limited exceptions.

Similar protections apply to other Federal benefits, including SSI, veterans' benefits, and railroad retirement. Protecting these benefits until debts are fairly negotiated is critically important during these tight economic times and very high gas prices.

Yet, despite these protections, creditors are able to obtain state court judgments against Social Security beneficiaries to collect their debts, and financial institutions then place a freeze on their accounts. The account holder can't access their own money, until they go to court and prove that the funds in their account are protected by Federal law.

In the meantime, on the hook for high fees, if they bounce a check they have to pay other bank costs. To address these issues, we know banking regulators have been doing a lot of talking. Today we will learn when we see action.

The second key issue we will hear about today is the impact of certain direct deposit arrangements referred to as master/sub-accounts. Generally, Treasury rules require that Federal benefit payments be deposited only in an account with the beneficiary's name, with certain exceptions. For years, Social Security has allowed certain individuals to have their benefits paid by direct deposit into a master account, under which the master account maintains separate sub-accounts for each of the seniors.

This arrangement began in order to make direct deposits to beneficiaries' investment accounts, and has expanded to nursing homes and religious orders, as long as the sub-accounts meet certain requirements, including that the beneficiary has complete access to their funds, being able to terminate the arrangement.

Social Security has learned that these master/sub-account arrangements have been undermined by some institutions, exposing beneficiaries to predatory lending practices. We will hear what action Social Security is taking in response.

Predatory lending is a terrible crime with devastating consequences to its victims. While determining how to stop these bad actors is a task that extends beyond the scope of our hearing today, and frankly, beyond the jurisdiction of this Subcommittee, this hearing will shine a bright light on the problem and the need for change.

There are many potential solutions to protecting beneficiaries, as we will hear from our Treasury witness today. One is the greater use of a pre-paid debit card offered to Social Security and SSI recipients who wish to receive their benefits electronically. Treasury has designated the Comerica Bank, headquartered in Dallas, as their fiscal agent to issue these cards. What better way to ensure the protection of essential benefit from garnishment and from bad actor lenders?

We can also protect beneficiaries by enforcing the law. State and Federal laws regulate the businesses we are discussing here today. I hope the Administration will assure us today that it is doing its job to ensure that these laws are followed.

Finally, and perhaps the most important way to protect beneficiaries is education. Individuals must be empowered to make the right choice. This includes full disclosure by banks and lending services of the cost of doing business, as well as public education about who the bad actors are, and how they can be avoided. It is important that people make a fully informed choice. Helping to educate the American people on making the right choice is always a good choice for Congress.

With that, I would yield back, Mr. Chairman.

Mr. POMEROY. Thank you, Mr. Brady. Before we turn to our first witness, the Chair asks unanimous consent that any additional opening statements submitted by Committee members be included in the record.

Without objection, the Chair asks that all witnesses statements be included in the record in their entirety, and so I will respectfully remind my colleagues to please keep your oral testimony to 5 minutes.

I now recognize our panel. Our first witness, Nancy Smith, Vice-Chair of AARP National Policy Council—we will just go right down the row—second, the Honorable Patrick O'Carroll, inspector general, Social Security Administration. Next, we will hear from Margo Saunders, of—the counsel for the National Consumer Law Center. Then, Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America. Finally, Dallas Salisbury, President and CEO of the Employee Benefit Research Institute.

So, Ms. Smith, please proceed.

STATEMENT OF NANCY SMITH, VICE–CHAIR, AARP NATIONAL POLICY COUNCIL

Ms. SMITH. Chairman Pomeroy, Ranking Member Brady, Members of the Subcommittee on Social Security, I am Nancy Smith, a volunteer member of AARP's National Policy Council, which recommends policy changes to the board of directors.

AARP commends this Committee's long-standing bipartisan concern that beneficiaries have unimpeded access to their Social Security benefits. Given Social Security's critical role in Americans' economic security, any action that blocks beneficiaries' access to their full Social Security benefits is a serious and unnecessary threat to the health and well-being of our older population.

This is particularly critical for the millions of beneficiaries who rely almost exclusively on Social Security. For almost one in three beneficiaries, Social Security represents at least 90 percent of their income. About 20 percent of elderly beneficiaries have only Social Security to live on.

The law in this matter is crystal clear. Section 207 of the Social Security Act says specifically that Social Security benefits are not assignable, transferable, or subject to garnishment. This section protects Social Security beneficiaries against destitution.

Despite this clear prohibition in the law, banks continue to freeze accounts containing exempt Federal funds. Other institutions, like payday lenders and check-cashing stores, are discovering ways to gain control of beneficiaries' money.

AARP believes all banks—preferably voluntarily, but through legislation or regulation, if necessary—should implement safeguards for customers whose accounts contain exempt funds. Some banks already do this, and they are not just the small, local banks. Citibank is one large banks that has found a way to protect its clients' funds.

In addition, imposing fees and penalties resulting from illegal garnishment is an unfair practice that must be stopped. If fees have been charged, they should be refunded. Banks may argue they lack the ability to discover which accounts have exempt funds, but we know this is not true. We are pleased to learn that the bank regulators are finalizing a proposal that would safeguard a specific amount of exempt funds from garnishment. We look forward to the opportunity to comment on this promising action.

Another practice that has emerged is the use of master/sub-account arrangements by payday lenders in check-cashing businesses. These arrangements were originally meant for people who have their check directly deposited into a brokerage account, or for nursing home patients who are required to contribute to the cost of their care, as well as for nuns with vows of poverty.

However, these arrangements have become a way for payday lenders and check cashers to gain control of Social Security checks to secure a payday loan and/or generate revenues from fees and surcharges. SSA has taken notice of this trend, and asked for comments on how to handle master/sub-accounts. We believe the Agency should exert even greater oversight on how these accounts are used, and by whom.

To a large extent, the beneficiaries can avoid payday lenders and check cashers through direct deposit to a bank account. The Federal Government has made a concerted effort to encourage beneficiaries' use of direct deposit. AARP agrees that direct deposit is the preferred method of receiving benefit payments.

For the unbanked, the new Treasury Department debit card option offers a chance to receive benefits without going to a check cashing outlet.

Mr. Chairman and Members of the Subcommittee, illegal garnishments are an improper use of master/sub-account arrangements, deprives Social Security beneficiaries of full access, control, and use of their monthly benefits. This is of great concern to AARP. We hope that the efforts underway today will address these concerns. If not, we will be back to ask for a legislative remedy.

Thank you for allowing us to appear before you today, and I look forward to a robust conversation through questions and answers.

Mr. POMEROY. Thank you.

Mr. O'Carroll.

[The prepared statement of Nancy Smith follows:]

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

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[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.

STATEMENT OF PATRICK P. O'CARROLL, JR., INSPECTOR GENERAL, SOCIAL SECURITY ADMINISTRATION

Mr. O'CARROLL. Good morning, Mr. Chairman, Congressman Brady, and Members of the Subcommittee. I thank you for your invitation to talk with you today, and for your interest in protecting Social Security beneficiaries.

As you know, Social Security beneficiaries are our most vulnerable and easily exploited citizens. Like you, we view any attempt to extract any part of these critical benefits to be an affront, even when it's not an actual crime.

Mr. Chairman, following news reports that indicated payday loan companies were preying on beneficiaries, you asked me to assess the scope of this problem. We recently completed this report, and I would like to share our findings with you.

By way of background, the Debt Collection Improvement Act of 1996 mandated that most Federal payments be made by electronic funds transfer or direct deposit. This process protects beneficiaries from some types of fraud, such as stolen checks. Unfortunately, it also creates a risk, in that neither SSA nor the beneficiary retains full control of the funds through the payment process.

Banks are at liberty to deduct fees from these direct deposits. In cases involving the payday lenders and other non-bank financial service providers, or FSPs, there is a second entity that has an access to the funds before the beneficiary does.

The Social Security Act has always prohibited the attachment or the garnishment of benefits. There are limited exceptions, such as income tax levy and child support. The advent of direct deposit brings new challenges.

Currently, FSPs can themselves establish accounts at traditional banks to receive Social Security benefits on behalf of an individual beneficiary. Unlike traditional checking or savings accounts, beneficiaries do not have direct access to the funds in these accounts. Instead, the funds are under the effective control of the FSP. Our work indicates that the banks deduct their fees, then they make the funds available to the FSP, which in turn deducts additional fees before ultimately making the remaining balance available to the beneficiary.

We studied five banks that we knew, from review of SSA records, to have financial relationships with FSPs, and found that SSA deposited over $34 million in benefits for over 63,000 supplemental security income recipients into accounts controlled by FSPs.

On average, check-cashing fees are conservatively estimated to be between $9 and $16. This means that the banks and the FSP partners charge these individuals between $567,000 and just over $1 million in check-cashing fees every month. Additional funds may be assessed for other services provided by the FSPs.

We also studied the demographics of the 63,000 beneficiaries: 96 percent were disabled, higher than the 82 percent of disabled individuals reflected in the SSI population at large; in addition, 55 percent of these individuals suffered from a mental disability. We found that the most prevalent mental conditions for this group included mental retardation, mood disorders, and psychotic disorders. Further, 76 percent of the individuals in our sample were minorities.

Interestingly, 42 percent had representative payees, individuals appointed by SSA to handle funds for those incapable of handling them on their own. This percentage closer reflects the overall SSI population. Although many of these representative payees could be family members who are also without bank accounts, this still raises the question in some cases as to whether the benefits are being used in the best interest of the beneficiaries.

While SSA has published for comment policy changes in this area, an act which I applaud, current policy is inconsistent. While some SSA policies appear to prohibit payday loan companies and similar organizations from engaging in this activity, other policies not only permit this, but provide instructions on how to facilitate the establishment of such accounts.

In fact, in some cases, SSA offices encourage this arrangement, especially for homeless beneficiaries. In at least one case, employees of an SSA office visited several FSPs, and then recommended their services to beneficiaries.

I am aware of the precarious balance SSA must strike in this area. The Agency must ensure that beneficiaries receive their benefits in a safe, electronic, and timely manner, while ensuring that beneficiaries retain absolute control over their funds. The proposed policy changes that SSA published in April are a step in the right direction. I believe more needs to be done to protect the funds that many of these beneficiaries so desperately need.

I look forward to working with you towards this common goal. I thank you for your interest, and I will be happy to answer any questions.

[The prepared statement of the Honorable O'Carroll, Jr. follows:]

Prepared Statement of The Honorable Patrick P. O'Carroll, Jr., Inspector General, Social Security Administration

Good morning, Chairman McNulty, Congressman Johnson, and Members of the Subcommittee, and thank you for your invitation to be here this morning to talk with you about an issue that causes my office as much concern as it causes the Subcommittee.

The Office of the Inspector General (OIG) for the Social Security Administration (SSA) is charged by statute with preventing and detecting fraud, waste, and abuse in SSA's programs and operations. While the majority of our work focuses on fraud, through our conduct of criminal investigations, and waste, through our audit work, the issue we are confronting today is one of abuse. Individuals receiving Supplemental Security Income are often among the most vulnerable members of our society. The elderly and the infirm often rely on Social Security payments for their very existence, living month to month on little or nothing but the assistance they receive each month from SSA. For a person or an organization to seek to extract what, for these individuals, are precious dollars, is certainly a crime, even though no criminal statute prohibits it.

Mr. Chairman, in a letter dated February 26, 2008, you asked my office to look into payday loan companies that may be taking advantage of some of SSA's most vulnerable beneficiaries to identify the nature and scope of the problem and suggest solutions to stop this abuse. We recently completed the requested report, and I'd like to share our findings with the Subcommittee.

Background

The ability of both banks and non-bank financial service providers (FSPs), such as payday loan and check-cashing companies, to access and assess fees against individuals' Social Security benefits exists purely as an as-yet unaddressed side effect of the advent of direct deposit. The *Debt Collection Improvement Act of 1996* mandated that most Federal payments be made by electronic funds transfer (EFT), or direct deposit. Title II beneficiaries and Title XVI recipients for whom payment by EFT would impose a hardship may request to be exempted from the EFT requirement. Recipients determine what constitutes a hardship, and SSA does not verify or document these self-determinations.

While EFT reduces the Government's workload, eliminates fraud associated with stolen checks and, in most cases, is safe and convenient for beneficiaries, it also creates a process by which neither SSA nor the beneficiary have full control over the funds throughout the entire payment process. Once sent by EFT, the receiving bank is able to assess such fees and deductions as it wishes. In cases where a non-bank FSP is involved, there are then two entities which are able to control, and assess fees against, these funds before the money is made available to the person for whom it was intended.

Since 1935, it has been illegal for Social Security payments to be garnished, attached, or subject to other legal process. The few exceptions to this prohibition currently include levy by the Internal Revenue Service and garnishment for child support. Of course, times change, and technology changes with them. It is critical that we examine whether current law is sufficient to protect the aged and the disabled from predatory practices in the EFT era.

How FSPs Function with Regard to Social Security Benefits

With beneficiary approval, non-bank FSPs can themselves establish accounts at traditional financial institutions and use those accounts to receive SSA payments intended for the beneficiary. Unlike traditional bank accounts, the beneficiary does not have direct access to deposited funds. Instead, the financial institution makes the funds, less a transaction fee, available to the non-bank FSP for disbursement to the beneficiary. The non-bank FSP then deducts additional fees for their services and makes the remaining balance available to the SSA beneficiary.

This practice appears to be inconsistent with Section 207 of the *Social Security Act,* which protects a beneficiary's right to receive benefit payments directly and use them as he/she sees fit by prohibiting the assignment of benefits. Assignment is the transfer of the right to, or payment of, benefits to a party other than the beneficiary or his/her representative payee. It also appears to be inconsistent with SSA policies prohibiting payment of benefits to anyone other than the beneficiary or representative payee. Specifically, SSA's policy states that "Any arrangement in which the claimant shares control of the funds from his or her benefit with a person or entity that has an interest in charging or collecting money from the claimant is an assignment-like situation that violates SSA's policy."

To further exacerbate an already troubling issue, we have seen cases in which a beneficiary using an FSP-established bank account for direct deposit notified SSA that he wanted to terminate the EFT agreement, and the following month, the FSP and the bank re-established the EFT against the beneficiary's wishes.

On April 21, 2008, SSA published in the *Federal Register* a proposed policy change to prevent deposits to "third party" accounts such as those I've described. I applaud this step, and encourage SSA to take all possible action to protect its beneficiaries.

Results of Our Audit

Our auditors performed a limited review of SSI payments electronically deposited into accounts at five banks known to have financial relationships with non-bank FSPs. While these are by no means the only banks used by FSPs to facilitate third-party accounts, we identified these five banks either because (1) their bank routing number appeared on payment records of SSI recipients whose address reflected the business name of a non-bank FSP; or (2) SSA identified the bank to us as the result of complaints received from SSI recipients.

Our review determined that, as of March 2008, SSA deposited the SSI payments of at least 63,065 individuals into accounts established and controlled by non-bank FSPs at these five banks. Monthly SSA payments deposited into these accounts total more than $34 million.

In a few hundred cases, SSA payment records reflected the non-bank FSP's name and address—indicating that SSA was aware that payments were going to the non-bank FSPs. However, in most cases, SSA payment records did not directly indicate non-bank FSP involvement in the payment transaction. In these instances, it appeared that SSI recipients or their representative payees entered into agreements with non-bank FSPs who, in turn, opened bank accounts on the recipients' behalf at traditional financial institutions with Department of Treasury-assigned routing numbers. Either the recipients submitted electronic deposit requests to SSA, providing the bank routing and account numbers used by the non-bank FSP, or the financial institution sent direct deposit auto-enrollment information directly to Treasury. In either case, once the direct deposit requests were processed, SSA began sending these individuals' payments to accounts effectively controlled by the non-bank FSPs. Once received, the financial institutions made the funds available to the non-bank FSPs for disbursement to the recipients. Before disbursement, the non-bank FSPs subtracted their fees from the recipients' funds.

Consumers who use non-bank FSPs typically pay higher costs in the form of transaction fees for financial services than individuals with traditional banking relationships. Treasury research indicates that Social Security recipients pay an average of between $9 and $16 in fees just to cash their Government check at a non-bank FSP. This suggests that the five non-bank FSPs and their financial institution partners charge the 63,065 recipients between $567,585 and $1,009,040 in monthly check cashing fees.

We also studied the demographics of the 63,065 beneficiaries in our sample. Seventy-six percent of these recipients were minorities. Ninety-six percent of the recipients were disabled—slightly higher than the 82 percent of disabled individuals reflected in the overall SSI population. Fifty-five percent of the individuals in our sample received SSI payments based on mental disabilities including mental retardation, mood disorders, and psychotic disorders. The age range of individuals in the sample was from four months old to 105 years old, and the median age was 42 years.

It is also notable that 42 percent of the population had representative payees—persons appointed by SSA to handle the payments of recipients unable to administer their own funds. While this percentage is closely reflective of the SSI recipient population at large, we believe the use of FSPs by representative payees casts doubt on whether the payments are in fact being used for the benefit of the recipient. We note, however, that SSA pointed out that many of these representative payees are equally poor family members who also may not have access to a traditional bank account.

SSA's Prevention of the Transfer of Payments to FSPs

As I stated earlier, SSA has published proposed policy changes to address these issues. However, at the time of our review, we found that in most cases, SSA was not aware that it was depositing SSI payments into accounts controlled by non-bank FSPs. Further, we identified no action taken by SSA to *prevent* the transfer of payments to payday lenders or any other non-bank FSP. On the contrary, though some SSA policies *appear* to prohibit these types of arrangements, other policies outline steps to follow to send payments *directly* to non-bank FSPs.

For example, one SSA policy states that, with the exception of Internal Revenue Service levy, child support (and/or alimony) garnishment, or state reimbursement, ". . . do not pay benefits to anyone other than the beneficiary (or his/her representative payee)." Another policy states that the Agency should ". . . avoid payment situations that give physical control over a benefit payment to someone other than the beneficiary; e.g., sending a benefit payment, either by check or electronically, to a loan company where the beneficiary has a loan . . . ." Yet another policy states that "Direct deposit payments cannot go directly to any of the following types of institutions:

- credit card companies,
- finance companies,
- insurance companies, or
- other non-traditional financial service companies."

Yet, in an apparent contradiction, another policy states that "Since direct deposit is now the presumed method of payment and will be required for all Government payments in the final phase of the new direct deposit requirements, many non-bank financial service providers, such as ***loan companies and check cashing facilities*** [emphasis added], now offer direct deposit for their customers. The direct deposit may be arranged in one of the following ways . . . ." The policy goes on to describe how to set up these direct deposits by stating, "This type of arrangement is acceptable and does not constitute assignment of benefits if all the following requirements are met:

- The benefits must be deposited in an account owned by the beneficiary at a Financial Institution . . .
- Enrollment must be voluntary on the part of the beneficiary.
- The beneficiary must be able to terminate the direct deposit arrangement upon request.
- Funds paid to a representative payee through a non-bank Financial Service Provider must be used for the beneficiary's current needs."

Despite this, in our review we identified two field offices that openly encouraged homeless SSI recipients to receive payments through local FSPs. Field office management visited local non-bank FSPs and compiled a short list of preferred vendors that wanted SSA customers.

Conclusion

Certainly SSA recognizes that this issue must be addressed, and the OIG acknowledges that electronic banking has increased the complexity of benefit delivery. SSA and the OIG agree that we must find a way to balance the need to pay beneficiaries in a safe, electronic, and timely manner with the need to ensure that beneficiaries have absolute control over their funds.

We look forward to continuing to work with SSA, and with this Subcommittee, to find solutions to these challenges and to protect and serve these most vulnerable beneficiaries and recipients. Again, I thank you for the invitation to speak to you today, for your interest, and for your continued support of our efforts. I'd be happy to answer any questions.

Mr. POMEROY. Thank you, Mr. O'Carroll.

Ms. Saunders.

STATEMENT OF MARGOT SAUNDERS, COUNSEL, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Thank you, Mr. Pomeroy and Mr. Brady, Members of the Committee. I am Margot Saunders, an attorney with the National Consumer Law Center. I represent the legal services attorneys across the nation who see the recipients of Social Security and other Federal benefits, and who have tried to help these recipients deal with the problems you are looking at today. I am here today on behalf of a broad coalition of both Federal, national, and state and local legal services and consumer advocates.

We very much appreciate the attention that this Committee and your staff, as well as the Senate Finance Committee, has paid to this problem. This issue has been growing at a faster rate for legal services clients across the country than any other legal problem.

We estimate that, on a monthly basis, tens of thousands of low-income recipients of Social Security, SSI, and other Federal benefits, whose benefits are entirely exempt from the claims of judgment creditors, are temporarily destitute when banks allow the attachments and garnishments to freeze the assets of these recipients.

We believe our estimate of over one million recipients of Social Security and other Federal benefits a year affected by this problem is conservative. My analysis is in a footnote. A million people a year have their benefits illegally seized by the banks to pay debts for which that money cannot be received.

We have been working with the Federal agencies—to Treasury, to the Social Security Administration, to the five Federal banking regulators. We have explained that the law is clear, that the remedy is within their means. As you obviously already know, everybody is pointing the finger at everybody else.

I was asked to explain in some detail exactly what happens to a recipient when their exempt money is frozen. The money is in the account, and the attachment order comes to the bank. The bank at that point, in most cases, simply applies the attachment order to the account, and the money in the account is frozen. In almost every state, the recipient must then find a lawyer, go down to the courthouse, file papers, and attempt to prove, through the use of both the account statements and other evidence, that the money in the account is exempt from collection.

If the recipient is dealing with a debt collector that has some feeling of responsibility, occasionally the money will be released once the recipient presents the proof. In most cases, that's not the situation, because the debt collectors knew that the recipient's money consisted of exempt funds all along.

In most cases, even when the recipient is able to go prove to the creditor and collector that the funds were exempt, the debt collector will not release the funds. When this happens, the only way for the funds to be released from the freeze is by court order and this requires a full court hearing. You have to have an attorney to have a full hearing, which leaves most low-income recipients dependent upon legal services. As you may know, legal services programs are woefully underfunded, and simply do not have the means to represent all the people that come through their doors on these problems.

Why is this problem so much bigger today than it was 10 years ago? Largely as a result of EFT–99, that was passed, as you have heard, in 1996 to require all Federal benefits to be electronically deposited. That has pushed more and more low-income, previously unbanked recipients into the banking system, allowing their money to now be accessible to judgment creditors.

The second reason is because of the credit card practices of many of this nation's banks. Credit card issuers routinely make credit cards available to people whom they know exist primarily or exclusively on exempt funds. So, when this credit is extended, these banks know that the money available to pay the debts are entirely exempt. Nevertheless, the credit is provided.

The third big issue that changes the complexion of the proposed—of a resolution is that the banks now can tell which funds are exempt and which funds are not. All the bank has to do in almost every situation is simply look at one more screen, and determine whether the money in the account came from a Federally exempt source.

Commingling of exempt funds should not stop the resolution here, because as we understand, as much as 80 percent of the accounts into which low-income recipients have their Social Security and other monies paid is commingled with other funds, even if it's only a $100 gift certificate, or $50 from a cousin.

There is a proposed solution on the table that I would like to comment on, but I can't, because I am out of time. I will say very quickly that it is not a solution to this problem to push people who are now using bank accounts out of bank accounts into the direct deposit card. One of the purposes of EFT–99 was to encourage low-income recipients of Federal benefits to use banks, and to ensure that they were not provided with second-class bank accounts. It would be a crime if, because of EFT–99, we then are pushing them back out of the banking system. Thank you.

[The prepared statement of Ms. Saunders follows:]

Protecting Social Security Benefits
from
Predatory Lending
and
Other Harmful Financial Institution Practices

June 24, 2008

Chairman McNulty, Congressman Johnson, 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 on behalf of the following national organizations representing low income recipients of federal benefits –

- **Consumer Federation of America**[2]
- **Consumers Union**[3]

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[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 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.

- **National Association of Consumer Advocates**[4]
- **National Legal Aid and Defender Association**[5]
- **National Senior Citizens Law Center**[6]
- **U.S. Public Interest Research Group.**[7]

In addition, I have gathered extensive information and advice on necessary and appropriate resolutions to the problems affecting low income recipients of federal benefits from a number of local, multi-county, and statewide legal aid programs across the nation. Attorneys at the following legal aid programs, all of whom represent low income clients affected by these problems, have provided critical information as we have constructed our proposed recommendations to the federal agencies dealing with these issues, as well as in our discussions with members of Congress about these issues –

- Community Justice Project of Harrisburg, Pennsylvania
- Coordinated Advice & Referral Program for Legal Services of Cook County, Illinois
- Empire Justice Center of Albany, New York
- Jacksonville Area Legal Aid of Jacksonville, Florida
- Legal Aid Society of Minneapolis, Minnesota
- Legal Aid Society of Roanoke Valley of Roanoke, Virginia
- Legal Advocacy Center of Central Florida, Inc of Sanford, Florida
- Legal Assistance Foundation of Chicago
- Legal Services of New Jersey of Edison, New Jersey
- MFY Legal Services of New York, New York
- Mississippi Center for Justice of 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
- St. John's University School of Law Elder Law Clinic of Queens, New York
- Virginia Poverty Law Center of Richmond, Virginia
- Washoe Legal Services of Reno, Nevada

You have asked me to address how the freezing of beneficiaries' bank accounts in response to state

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[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 **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.

court garnishment orders on behalf of creditors implicates Section 207, the devastating impact account-freezing can have on Social Security beneficiaries, and what policy responses might be taken stop or mitigate the practice. We very much appreciate your concern about these issues. Indeed it is the most vulnerable of our society -- and those with the least power -- who suffer daily as the result of the problems highlighted in this hearing.

The Problem – Recipients Starve as Debt Collectors Claim Exempt Funds

We estimate that on a monthly basis tens of 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. We believe our estimate of over **1 million recipients of Social Security and other exempt federal benefits a year who have their funds illegally frozen by banks** is very conservative, and that the real number is likely much higher.[8]

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.*"),[9] 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 Law – Exempt Benefits Must Be Protected.

The law could not be clearer. To preserve federal benefits for their intended recipients, Congress provided that the benefits cannot be seized to pay 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 Social Security Act specifically says:

> The right of any person to any future payment under this subchapter shall

[8]If we assume that Social Security and SSI recipients carry and default on credit cards at the same rate as the general population (the current rate is 5.7% of all credit cards are in default) this means about 2.85 million of the country's 50 million Social Security recipients would have judgments taken against them for credit card debts just in the last year. We can then reduce that number by 50% to make up for the fact that the assumption is based on an extrapolation, but this still means that well over 1 million recipients of Social Security and SSI have credit card judgments applied against them each year. This analysis is based on information from Moody's Investors Service, a bond-rating agency, which has noted that more U.S. consumers are beginning to fall behind on credit-card payments. Moody's reported the charge-off rate at 5.7% in May 2008, up from 4.5% the previous year. *Sector Snap: Credit card companies fall on outlook.* May 20, 2008 1:40 PM. ET. http://news.moneycentral.msn.com/provider/providerarticle.aspx?feed=AP&date=20080520&id=8671348

[9]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

> not be transferable or assignable, at law or in equity, and <u>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.</u>[10] (Emphasis added.)

What words could be used to make these protections any clearer? The *words in these statutes* apply as against all parties -- creditors, judgment creditors, debt collectors, and banks.

This nation's courts have consistently said that exemptions are to be liberally construed in favor of the debtor.[11] The United States Supreme Court has repeatedly reiterated that Social Security,[12] and

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[10]Social Security Act, at 42 U.S.C. § 407(a). The protections are similar in the other federal statutes governing federal benefits:

- <u>Veterans benefits:</u> "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).
- <u>Railroad Retirement benefits:</u> "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.
- <u>Federal Retirement program benefits:</u> "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.

[11]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

Veterans Benefits[13] 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,[14] regardless of whether the creditor is a state or a private entity.[15]

In *Porter v. Aetna Casualty and Surety Co.*,[16] the Supreme Court held that federally exempt disability benefits deposited in a bank account remained exempt so long as they are readily traceable and "retain the

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(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).

[12]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).

[13]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).

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

[15]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).

[16]370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962).

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."[17] This rationale has been widely applied to other exempt benefits, to hold that exempt funds remain exempt in checking,[18] savings,[19] or CD[20] accounts so long as these are "usual means of safekeeping" money used for daily living expenses.[21]

The Policy – Exempt Benefits Must Be Protected.

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, the elderly, and the disabled. 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 repeatedly articulated the underlying reasons for these 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

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[17] *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).

[18] 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).

[19] 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).

[20] *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).

[21] *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).

his creditors.[22]

Seizures of Exempt Funds Violate Both the Law and the Policy.

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 recipients must find attorneys 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. In some jurisdictions, forms for this purpose are not available at local courthouses, and there is no established procedure for presenting this information to the creditor. Thus even in the best and rare case scenario, where the debtor is able to unfreeze the account in a week or two, significant harm generally occurs.

Even when proof that the funds are exempt is presented to the creditor, 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 generally 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.

Moreover, quite often, if after the recipient successfully proves that an attachment or garnishment order was wrongly applied against exempt funds, the judgment creditor sends another order, based on the same judgment.[23] This requires the recipient to repeat the process of showing the funds are exempt. Because of the sheer number of difficulties involved (finding an attorney, going to the courthouse, filing papers, going through a hearing, waiting for the bank to released the funds), the recipient either gives up and allows the funds to be paid to satisfy the judgment, or drops out of the banking system -- receiving

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[22] *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).

[23] *See, e.g.* Mayers v. N.Y. Cmty. Bancorp Inc., No. CV 03 5837, 2005 WL 2105810. (E.D.N.Y. Aug. 31, 2005).(creditor hospital restrains disabled SSI recipients account three times); Washington v. Gutman, Mintz, 07 CIV. 4096 (EDNY 2008) (FDCPA claim against creditor who, over 22 months, restrained homeless woman's SSI account three times for the same debt.).

future federal benefits by paper check.[24]

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.

The New Realities Require Clearer Prohibitions.

Three critical elements dictate a change in the legal response to attachment and garnishment orders applied against exempt funds in bank accounts:

- <u>Tens of millions of low-income recipients of federal benefits now have their payments directly deposited into bank accounts, where they had previously received paper checks</u>. For example, in 1985, 41.5% of Social Security recipients and 12.4% of SSI recipients received their payments electronically. By 2008, these percentages have risen to 85% and 59% respectively.[25] 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 payments (except income tax refunds) be electronically deposited.[26]

- <u>The number of judgments *against* these impoverished recipients of federal benefits has escalated dramatically in recent years</u>. As the credit industry continues to provide high priced credit to low-income recipients, and piles on astronomical late fees, over the limit fees, and exorbitant interest rates, the unpaid debts of these low-income recipients continue to mount. This higher and higher level of unpaid debt, in turn, creates a greater demand for access to these funds which are intended to be sacrosanct and kept for the sole purpose of protecting the recipients from impoverishment.[27]

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[24] *See, e.g.* Miceli v. Lincoln Financial, 17 Misc.3d 1109(A), 2007 WL 2917242 (2007 N.Y.Dist.Ct.)(Court finds "unequivocal proof" that taken moneys were exempt based on exact evidence the debtor gave the creditor out of court.).

[25] http://www.ssa.gov/deposit/trendenv.shtml.

[26] 31 U.S.C. § 3332. *See also* 31 C.F.R. § 208.1. 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. *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. *However, we have been told by Treasury officials that they are intending changing the current regulations to* require *direct deposit for all federal recipients who have bank accounts.* Needless to say, this would considerably exacerbate the disastrous dangers facing recipients subject to the freezing of exempt funds.

[27] For an explicit explanation of the degree to which predatory lending, especially credit card lending, is the cause for these explosions of unpaid debt among this nation's seniors, see, "Debt Weight, The Consumer Credit Crisis in New York City," Community Development Project, Urban Justice Center, October, 2007. http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf.

- Electronically deposited federal benefits are easily identifiable. In the past, the claim that it was burdensome for the banks to look first before applying an attachment made some sense. The funds were generally all deposited in a paper format and more intricate inquiry was required to determine the genesis of each deposit. Now, the situation is quite different. *Banks can easily identify the electronically deposited federal benefits we are asking the agencies to order them to protect.*

The banks have claimed that it is difficult or impossible for them to determine whether there are exempt funds in an account before implementing a garnishment order. This claim is belied by the fact that *some banks currently identify electronically deposited exempt funds, and refuse attachment orders against those funds.*[28] 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.

Before electronic deposit of federally exempt funds was commonplace, and pursuant to the required balancing test dictated by the seminal Supreme Court case of *Mathews v. Eldridge,*[29] the courts had allowed the temporary freezing at issue here.[30] But the courts are now recognizing that technological changes that make it so easy to identify the funds as exempt, when weighed against the terrible harm caused to recipients by the attachment of exempt funds, may necessitate a different constitutional response.[31] The courts in these cases have reached this preliminary conclusion based only on the constitutional balancing tests between the interests of the parties. The cases have not yet dealt with the issue of whether the Supremacy Clause of U.S. Constitution would dictate that the protections of Section 407 of the Social Security Act (and the similar provisions of the other federal benefit statutes) trump conflicting state law

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[28]The fact that many banks currently identify electronically deposit exempt funds and refuse attachment and garnishment orders against these funds was discovered by Johnson Tyler, attorney for low income recipients of federal benefits from South Brooklyn Legal Services, in his efforts to resolves these problems for his clients. The banks which have indicated to him that they already identify electronically deposited, exempt funds include: New York Community Bank, Rosslyn Savings Bank, JP Morgan Chase and Household Bank. All of these banks except Household then return the attachment or garnishment order unsatisfied if they find that the accounts contain only electronically deposited, exempt federal payments. Apparently Household allows the attachment order, even against exempt funds, when the creditor demands it.

[29]424 U.S. 319, 335, 96 S.Ct. 893, 47 L.Ed.2d 18 (1976).

[30] *See, e.g.* Huggins v. Pataki, No. 01 CV 3016, 2002 WL 1732804 (E.D.N.Y. Jul. 11, 2002) in which the district court refused to reapply the constitutional balancing test in light of the technological changes of direct deposit because of the Second Circuit decision in McCahey v. L.P. Investors, 774 F.2d 543 (2d Cir.1985).

[31]*See, e.g.* Granger v. Harris, 2007 WL 1213416 (E.D.N.Y., Apr 17, 2007) (recipient stated § 1983 claim against bank that disbursed funds to creditor, despite knowledge that funds were Social Security; state statute imposing sanctions on bank that failed to comply with restraining order was state compulsion sufficient to allege action under color of state law); Mayers v. New York Cmty. Bancorp, Inc.,2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005) (refusing to dismiss due process claim against banks and others for failing to protect Social Security benefits in bank account from garnishment order), later decision, 2006 WL 2013734 (E.D.N.Y. July 18, 2006) (denying defendants' motion for interlocutory appeal).

dictates regarding the freezing of federally exempt funds.[32]

Commingling of Funds Should Not Stop Protection of Exempt Funds

Most involved in this ongoing dialogue seem to agree that requiring the bank which receives the garnishment order to look at the account before freezing the funds is not too onerous. If the only deposits in the account are unambiguously exempt funds, the order should be returned unsatisfied. The complexity arises when the exempt funds are commingled with non-exempt funds.

Commingling appears to be the norm, rather than the exception – 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.[33]

While commingling of exempt funds with non-exempt funds or funds of another raises the problem of traceability, in the context of garnishment or attachment proceedings, these issues are generally resolved in a court of law. 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,[34] generally applying a first-in first-out accounting method.[35] A small minority of courts have refused to require tracing, finding that the

[32]However, the courts in both the Granger and the Mayer's cases appear to recognize the potential for this potential preemption.

[33]An official from the FDIC has estimated that as many as 80% of bank accounts into which exempt Social Security and SSI funds are deposited are commingled with non-exempt funds. Meeting between federal banking regulators and consumer advocates, March 18, 2008, Washington, D.C.

[34] Granger v. Harris, 2007 WL 1213416, E.D.N.Y.,2007, Apr 17, 2007 (noting that exempt benefits do not lose their exempt status even when commingled.); 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); 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).

[35]*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).

exemption was lost when the funds were commingled.[36]

However, an alternative, mathematically simpler system 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 seizure.[37] A simple system such as this provides certainty and ease of use for the banks, as well as basic protections for the recipients.

Exempt Funds Can Be Protected from Seizure

The issue here is the need for an *immediate determination* of the exempt funds, and which funds can be appropriately frozen and which funds should be protected from garnishment because of their exempt status. State laws on exemptions, garnishment and attachment may not include the procedures necessary to properly protect funds from freezing which are exempt under federal law, but that cannot mean that those federally exempt funds lose their status as exempt funds.

State law cannot take away the protected status of exempt funds provided by federal law. In many states, the exemptions allowed under state law must be affirmatively asserted to be preserved. Some states provide a method to identify exempt property prior to seizure, while others only provide that the consumer can go to court after the seizure to obtain the return or release of the property. There is a critical distinction between property which is exempt under state law and that which exempt under federal law. If federal law specifies that property is exempt, a state law cannot properly be interpreted to have the effect of denying the recipient that exemption because of the recipient' s failure to follow the state law. Banks often argue that they perceive a risk of liability or sanctions if they disburse funds subject to a garnishment order to debtors. In actuality, it seems highly unlikely that a bank would be sanctioned for refusing to freeze funds that are unequivocally exempt under federal law.

In years past courts generally held that banks do not have a duty to make an independent evaluation of whether a bank account contains exempt funds, for the purpose of refusing a garnishment order. The courts generally found against the recipient, reasoning that the bank had no duty to determine whether a portion of the funds were exempt.[38] Now, as has been recognized by a number of courts, when the debt

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[36] *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.* cases noted in Note 34, *supra*.

[37] *See, e.g.* West's Ann.Cal.C.C.P. § 704.080.

[38] *See, e.g.*, Gorstein v. World Sav. Bank, 110 Fed. Appx. 9 (9th Cir. 2004); Parker v. Wetch & Abbot, P.L.C., 2006 WL 4846042 (S.D. Iowa July 11, 2006) (freeze of account containing exempt benefits did not violate anti-alienation clause of Social Security Act, nor state or Federal Fair Debt Collection Acts, nor state consumer protection law); Alexander v. Bank of Am., 2007 WL 3046637 (W.D. Mo. Oct. 17, 2007) (bank not liable for six weeks' freeze of SSDI benefits; only remedy for violation of anti-alienation clause is release of garnishment, no private right of action for damages; no intentional infliction of emotional distress where bank acted "promptly" to release garnishment; court assumes that bank could not know funds were

collector has reason to know that the funds are exempt, and processes a garnishment regardless, the collector risks violating a variety of state and federal laws.[39] There is likely to be similar liability for a bank's refusal to release clearly exempt funds to the recipient.

A few states have updated their garnishment statutes or court rules to address the need and the current ability to protect direct-deposited exempt benefits. Pennsylvania rules of civil procedure state explicitly that service of the writ will not attach funds in an account in which funds are direct/deposited on a recurring basis, and identified as exempt under state or federal law.[40] A debtor's failure to claim the exemption does not result in waiver.[41] Connecticut and California provide that a modest amount of benefits are exempt without making a claim, and Connecticut specifically confers immunity on a bank that attempts in good faith to comply with the statute.[42] In both states, however, the debtor must file a claim to prevent the freezing and turnover of any *additional* exempt amount.

In other states, it is necessary to construe the federal and state statutes and rules harmoniously. The state statutes may define exempt property under state law, prescribe the form for the garnishment summons and the bank's response, and establish a procedure for claiming exemptions. Many of these statutes were enacted long before direct-deposit, or even exempt benefits under federal law, existed. Even in these states, state laws cannot abrogate a federal right, especially when the federal law establishing the exempt status of the funds is clear. It seems highly unlikely that a state statute could be interpreted to mean that funds which are exempt under federal law can lose that protected status just because a recipient fails to follow a state required procedure. Also, the principle of liberal construction, as well as the public policy served by the benefit programs, both support a construction that allows banks to disburse to debtors funds

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exempt until debtor formally claimed exemption).

[39]Mayers v. New York Cmty. Bancorp, Inc. 2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005) (recent changes in technology, i.e., electronic direct deposit of Social Sercurity benefits and ease of identifying deposits as exempt funds, require a re-evaluation of New York procedure allowing pre-judgment freeze of bank accounts), *later decision*, 2006 WL 2013734 (E.D.N.Y. July 18, 2006) (defendants' motion for interlocutory appeal denied). *See also* Hogue v. Palisades Collection, Inc., 494 F. Supp. 2d 1043 (S.D Ohio 2007) (debtor stated claims under federal and Iowa fair debt collection acts, Iowa Uniform Consumer Credit Code, tort claim for abuse of process against creditor and its attorney; garnishment continued after being shown affidavit and bank statements showing that account contained only exempt Social Security); Jordan v. Thomas & Thomas, 2007 WL 2838474 (S.D. Ohio Sept. 26, 2007) (FDCPA claim stated; frozen account contained only exempt Social Security; genuine issue of fact whether collector's attorneys conducted investigation or had reasonable cause to believe account contained non-exempt funds); Lee v. Javitch, Block, & Rathbone, 2007 WL 3332706 (S.D. Ohio Nov. 7, 2007) (Ohio statute cited in *Todd* has been amended to require only "reasonable cause to believe"; genuine issue of fact as to reasonable cause where large-volume collection firm did crude screening, i.e., eliminated debtors aged over 65 with no employer or trade lines listed on credit report; summary judgment denied on FDCPA and UDAP claims). *But see* Parker v. Wetch & Abbot, P.L.C., 2006 WL 4846042 (S.D. Iowa July 11, 2006) (freeze of account containing exempt benefits did not violate anti-alienation clause of Social Security Act, nor state or federal fair debt collection acts, nor state consumer protection law); Smith v. Levine, 2006 WL 3704622 (Cal. Ct. App. Dec. 18, 2006) (litigation privilege barred abuse of process claim arising from levy on non-debtor's account, and conversion claim arising from refusal to return improperly seized funds).

[40]Pa. R. Civ. P. 3111.1.

[41]Cal. Civ. Proc. Code § 704.080 (West); Conn. Gen. Stat. § 52-367b.

[42]*Id.*

that are clearly exempt. A few New York courts have ordered creditors to include in their restraining notices, which are served on banks to initiate a garnishment, a check box to indicate that the bank holds directly deposited exempt funds, and instructions that such funds should not be restrained.[43]

It is very important not to create the incentive for Social Security and other beneficiaries to have second class bank accounts – as would happen 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 be an odd 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.[44]

Fees Charged Social Security Recipients and Others Should Be 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.

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 mostly from 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.

Treasury is Poised to Propose a Good Compromise

We understand that as the result of extensive discussions and negotiations between Treasury and the Social Security Administration, the other federal payment agencies, and the federal banking agencies,

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[43] Lincoln Fin. Services, Inc. v. Miceli, 17 Misc. 3d 1109(A) (Dist. Ct. 2007) (table) (text available at 2007 WL 2917242) (ordering creditor to include instructions about exempt funds in any future restraining notices against this debtor); Contact Res. Services, Inc. v. Gregory, 806 N.Y.S.2d 407 (City Ct. 2005) (protective order as to specific debtor).

[44] *See* 142 *Cong. Rec.* H48721 (1996).

that a compromise regulation will be proposed in the near future. Our understanding of this compromise is that it will incorporate *at least* the following features:

Upon receiving an order to freeze a bank account pursuant to a garnishment or attachment, a bank will --

1. Review the electronic deposits made into the account in the previous 30 to 45 days (called the "*look-back period*"), to determine whether any are accompanied with the electronic designation for federally exempt funds.
2. If there are any exempt funds deposited into the account, then the total amount of exempt funds deposited within the look-back period will be multiplied by a factor (either 2 or 2.5, or some other number to be determined – this is called the *"multiplier")*.
3. The multiplied sum of exempt funds will be considered the *protected amount* – this amount of money will always be kept safe from freezing or attachment or garnishment, regardless of the flow of money into and out of the account.
4. Funds in the account which are in excess of the multiplied sum will be frozen and held pursuant to state law for disposition.
5. The recipient will be free to seek to protect all exempt funds *over* the *protected amount* using the standard state court procedure.
6. No garnishment fees assessed by the bank can be taken from the *protected amount*.

We think this proposal is a potentially wonderful resolution to this difficult situation. There are, however, a number of important issues still to be resolved. These include --

- *The amount of the multiplier is critical.* Although recipients will be able to go to court to protect exempt funds which are over the *protected amount*, in reality very few recipients will have the means to do this. As a result the *protected amount* will become the *de facto* exempt funds kept safe from the claims of creditors. As it is so imperative that these funds remain available for recipients to use for intended life-sustaining purposes, the multiplier should be at least 2, if not more. If the multiplier is not sufficiently high, savings will be discouraged, and a bank account will remain an unsafe way for recipients to manage their financial affairs.

- *No bank fees should be permitted to be withdrawn from protected funds.* If some funds are frozen, then checks and debits made by the recipient based on the expectation of the availability those funds may bounce. When subsequent deposits are made into the account -- replenishing the *protected amount* – no fees resulting from the freezing or the garnishment or attachment order should ever be withdrawn from the *protected amount*. This prohibition must include NSF fees, as well as all other fees which are the natural consequence of the garnishment order.

- *Notice of the freezing must be immediately provided to the recipient.* The bank should be required to provide notice immediately to the recipient of --
    - the pendency of the garnishment or attachment order, the date it was entered, and the amount;
    - the effect of the order as applied to the funds in the recipient's bank account -- showing which funds are frozen pursuant to the order, and which funds will remain free from the order;

    - assurance to the recipient that all funds within the *protected amount remain available for the recipient's use;*
    - subsequent funds deposited into the account will also be protected up to the *protected amount;*
    - state court information regarding how the recipient can claim state exemptions and protect funds over the *protected amount.*

- *More protective state rules apply.*

Conclusion

The Appendices to this testimony include dozens of case histories of real people whose lives have been terribly effected by the illegal freezing of their protected funds. People go hungry, rent goes unpaid, there is no money for medicine, transportation. The consequences are devastating. As all of these recipients can explain, having a bank account frozen when you have no other money is a terrible experience. Unfortunately, these case histories are 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).

The real-life stories recited in the Appendices includes names, dates and the names of the banks involved. 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, Georgia, Illinois, Michigan, Mississippi, Montana, Nevada, New Jersey, New York, Pennsylvania, Virginia.** Unfortunately, for every specific story included in this testimony, there are tens of thousands more.

I would be happy to answer any questions.

Appendices
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
Nevada
New Jersey
New York
Pennsylvania
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. 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. Although a settlement was eventually reached, the garnishment caused 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

Juanita Johnson is 74 years old and relies on Social Security and a VA pension as her only source of income. In March 2005, a judgment was entered against her from an old credit card account. Believing that she had paid the debt in full after disposing of the credit card seven years prior to the judgment, but unable to find legal representation, Ms. Johnson appeared in court without a lawyer and unsuccessfully contested the claim. A lawyer from the collection agency gave the court an affidavit from his company and a judgment was entered against Ms. Johnson over her objections.

A few months later, Ms. Johnson was commanded to come back to court to disclose her collectible assets. She was sworn under oath and interviewed outside the courtroom where she told the collection lawyer that her only income was her VA pension and Social Security. After the collection attorney demanded that she make arrangements to pay, Ms. Johnson agreed to pay $20 a month towards the judgment. Ms. Johnson was not informed that her Social Security and VA pension were exempt from garnishment.

After temporarily entering a nursing home in late 2005, Ms. Johnson missed two payments and subsequently received notice that her rent check had bounced. Ms. Johnson then contacted her bank where she was informed that her account had been frozen. Ms. Johnson was unable to pay bills from her account for three weeks. She bounced six checks and was forced to ask her doctor to write her electric company to ask that they not disconnect her power.

Ms. Johnson was eventually informed that she should contact a legal aid lawyer and was advised that her income was exempt from garnishment. Her lawyer was able to get the freeze lifted, but only after collection agency said they had no record of her many conversations with them where Ms. Johnson informed them that her only income was through pension disbursements.

Attorneys for the collection agency failed to appear when Ms. Johnson's lawyer went to court and successfully petitioned the judge lift the freeze. However, despite the court order, the bank waited an additional four days before allowing Ms. Johnson to access her account.

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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

1. 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.

2. 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.

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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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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 and plaintiff's counsels, the bank finally agreed to release Ms. H's funds. The process took over two weeks, during which time Ms. H was without her life supporting medication, as a result her health deteriorated.

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New York

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.

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New York

1. 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.

2. 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.

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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.

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.

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. 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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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 froze 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 means to travel other than public transportation. She is now too frightened of the banking system to trust them again and has left a few dollars in her account to keep it open, but is too afraid to use it.

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Mr. POMEROY. Thank you.
Ms. Fox.

STATEMENT OF JEAN ANN FOX, DIRECTOR OF CONSUMER PROTECTION, CONSUMER FEDERATION OF AMERICA

Ms. FOX. Chairman Pomeroy, Representative Brady, Members of the Committee, I am Jean Ann Fox. I am director of financial services for Consumer Federation of America. I am also testifying today on behalf of the National Consumer Law Center and Consumer Action.

We appreciate your attention to the problems that low-income Federal benefit recipients are experiencing with high-cost financial service providers. These companies are stripping hundreds of millions of dollars in taxpayer-funded benefits from the pockets of Social Security, SSI, and other Federal beneficiaries.

As others have told you, this money is supposed to be safe from attachment, from the reach of credit providers. This money is supposed to provide for subsistence income for the most needy in our country. Yet, financial service providers have found a way to put their hands in this pot of reliable Federal money in order to deliver financial services, but to gain access to exempt funds.

There are several types of financial arrangements that have been described in the news coverage of this issue, and I would like to separate those out for you, because the solutions differ, depending on how the financial services are being provided. In my written testimony, I give you a great deal of detail about the providers that we have some information on.

We need to separate out recipients into two groups. About 80 percent have bank accounts, and they are vulnerable to payday lenders. The unbanked recipients are susceptible to the direct deposit providers. There are a handful of banks that partner with check cashers, stores, installment loan companies and other storefront financial providers, to use the master/sub-account arrangement for exempt funds to be deposited to them, and then it's made available to the check casher. The recipient comes in, and that electronic deposit is converted back into a paper check, which they then pay to cash, or it can be loaded onto a prepaid debit card that comes with a lot of fees.

Let me give you an example of what this means to a recipient. A Philadelphia SSI recipient who was getting about $580 a month only received about $566 in a cashier's check every month when he went to the check-cashing outlet to get direct deposit of his benefits. The bank took out $9.95 a month to deliver the payment to the check casher. They deducted $2.95 for the check casher to print this electronic transmission back into a cashier's check, and then this gentleman had to pay to cash the check.

The average check-cashing fee to cash a government benefit check, based on a 2006 survey we did, is 2.44 percent of the face value of the check. So, this gentleman was paying about $24 a month out of his meager $580, just to get the money into his pocket. He did not have control of the direct deposit of his funds.

This bank also offered a cash advance product, turning this direct deposit arrangement into a credit transaction. They would loan up to $200 a month. They took out $10 for their finance charge, they took out $10 for the check casher's part of the finance charge, and delivered a $180 cashier's check for the proceeds of the loan.

Every month, when his SSI benefits were direct deposited into that master account, they paid back the loan in full, leaving him extremely short. So, of course, he took out another loan every month. Over a period of about 33 months, this gentleman paid almost $660 in finance charges to use $180 over and over. That is permitted, under this master-sub-account arrangements.

Another one of the providers is Republic Bank and Trust, which has a Currency Connection program that is marketed to check cashers and loan companies. It's marketed as a way to help loan companies collect payments from exempt funds, and also as a way to deliver proceeds to the folks over the counter. They charge to handle each check, and then they charge to produce each check, and then they charge to cash each check, deducting funds from people.

They also have an overdraft feature on this direct deposit account that will let you overdraw your account, and they will charge you 25 percent of the amount. So, if you have the loan out for a whole month, you are paying 300 percent annual interest for access to exempt funds which are supposed to be safe from creditors.

The story in the Wall Street Journal that got a lot of attention was a gentleman in Alabama who went to his local small loan company every month to get what was left over from his Federal benefits check after the bank and the lender deducted their fees and his installment loan payment. That company markets its services by claiming that beneficiaries will be able to make their monthly loan payment as soon as the benefits become available at the bank. Those are the services that target the unbanked.

Now that we have so many Federal benefit recipients who have bank accounts, they are now eligible to get payday loans, and those are quick cash advances for a few hundred dollars that are secured by your personal check written for the amount of the loan, plus a finance charge or an electronic debit to your account, held until your next payday, and then all of that money gets paid back in one balloon payment.

Those loans cost 390 percent annual interest or higher. Recipients who are getting $25,000 a year, which would be a couple getting two Social Security payments or somebody who is also getting other income and Social Security, would be in the hole $158 if they pay back the average payday loan on time out of their exempt benefits.

We urge this Committee to exercise your authority to encourage the Social Security Administration to stop the use of master/subaccounts to deliver exempt funds to recipients. We urge Treasury to finish the job they did not do when EFT–99 rules were being written, to prevent financial service companies from being a conduit for the direct deposit of benefits, and we urge your attention to the payday loan issue. I would be glad to answer your questions.

[The prepared statement of Ms. Fox follows:]

Prepared Statement of Ms. Fox, Director of Consumer Protection, Consumer Federation of America

Chairman McNulty, Congressman Johnson, and Members of the Committee, my name is Jean Ann Fox and I am director of financial services for the Consumer Federation of America (CFA).[1] I am testifying today on behalf of CFA and National Consumer Law Center[2] on behalf of its low income clients. I appreciate the opportunity to offer our comments on financial services and credit products that harm Social Security and SSI recipients.

Federal benefit recipients are being charged steep fees for direct deposit arrangements and exorbitant interest rates for loans based on future receipt of exempt federal funds. Check cashers and loan companies partner with a few banks and intermediaries to provide "direct deposit" of Social Security, SSI, VA benefits, and federal pensions through accounts only accessible at the local check casher or loan company or through a high-fee debit card. Not only are these second-class bank accounts expensive, they deprive recipients of control over their exempt funds and divert protected funds to repay high cost loans either to the bank handling the direct deposit or to a loan company partnering with the bank.

Federal Benefits Needed for Basic Essentials, Not Harmful Financial Products

Federal law protects the subsistence income provided by tax-payers to retired workers, disabled Americans, orphans and survivors, veterans and federal retirees. This income is intended to relieve poverty and ensure minimum subsistence income. Creditors are prohibited by Section 207 of the Social Security Code from attaching, garnishing, or otherwise taking funds meant to provide basic essentials.[3] Despite federal protection of exempt funds, Treasury and the Social Security Administration have permitted exempt funds to be funneled through master/sub accounts at fringe financial outlets. In addition, payday lenders make triple-digit interest rate loans to beneficiaries, secured by unfunded checks or debit authorizations for bank accounts into which exempt funds are deposited.

Federal Policy Exposes Recipients to Harmful Financial Products

The Congressional decision to mandate distribution of federal benefits by direct deposit had the unintended side effect of exposing recipients to new forms of high cost financial services.[4] Unbanked federal recipients were mandated to open bank accounts to get direct deposit instead of receiving paper checks in the mail each month. Those who opened bank accounts became eligible for payday loans. Those who did not have access to mainstream bank accounts and claimed a hardship waiver were solicited to get direct deposit through their corner check cashers and similar outlets. Under procedures permitted by the Social Security Administration, a few banks receive direct deposit of exempt federal benefits into master accounts to enable loan companies to deduct payments and fees before the remaining monthly SS, SSI or other federal payment was handed to the beneficiary.

Earlier this year the Wall Street Journal published a front page story, titled "Social Insecurity: High Interest Lenders Tap Elderly, Disabled,[5]" which described the high cost and unfair terms of financial arrangements that target low-income recipients of taxpayer-supported federal benefits. Readers were shocked to learn that the Social Security Administration would direct deposit SS and SSI benefits into a bank account controlled by a loan company, not by the recipient. Maps illustrated the clustering of high cost payday lenders near Section 8 housing in six major cities to show the concentration of high cost lenders in neighborhoods with low income populations. We appreciate the response from this Committee and the Social Security Administration to address the problems exposed by the report.

Social Security Administration Reexamines Delivery of SS and SSI Benefits through Master/Sub Account Arrangements

The Social Security Administration requested comments from the public on whether they should terminate delivery of benefits through master/sub accounts. We appreciate their attention to this problem and filed comments in that docket, urging a halt to delivery of benefits through financial service companies. But even if the SSA stops the master/sub account delivery of SS and SSI checks, that does not pro-

[1] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interest through advocacy, research and education.

[2] The **National Consumer Law Center** is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, who represent low-income and elderly individuals on consumer issues.

[3] Social Security Act, at 42 U.S.C. § 407(a).

[4] Debt Collection Improvement Act of 1996, called "EFT'99."

[5] Ellen Schultz and Theo Francis, "Social Insecurity: High Interest Lenders Tap Elderly, Disabled," *Wall Street Journal,* February 12, 2008, A1.

tect other recipients of exempt federal funds, including veterans, railroad pensioners, and federal pension recipients. In addition, only Congress can enact protections against securing loans with unfunded checks or required debit access to bank accounts. That is why your attention to this problem is so important.

Financial Products Target Exempt Benefits and Bank Accounts

Hi-jacking direct deposit of benefits: The Social Security Administration and Treasury permit delivery of exempt benefits through master/sub account arrangements that can include a bank, an intermediary, and the outlet where consumers go to pick up their "checks." Unbanked recipients are targeted by these "third-party direct deposit providers" as a means of getting faster access to their checks that is safer than receiving paper checks in the mailbox. Loan companies also use the direct deposit arrangements to secure repayment of loans before recipients gain access to their funds. There are at least three variations on these arrangements:

- Third-party direct deposit arrangements for delivering federal benefits to unbanked recipients through check cashers and other financial outlets.
- Master/sub account arrangements that deduct loan payments from exempt funds before the balance is paid to recipients at loan company offices.
- Third-party direct deposit accounts that extend high cost credit via debit card overdrafts and cash advances on the next month's benefits.

Payday loans secured by bank accounts into which exempt funds are direct deposited: A new and growing threat to exempt funds is posed by payday loan companies that make loans to federal benefit recipients who have bank accounts of their own and borrow by writing a post-dated check for the loan and finance charge which deducts exempt funds from their bank accounts. Some payday loans also use electronic authorization to withdraw payment directly from borrowers' bank accounts as soon as exempt funds are deposited.

The key feature of the master/sub account product is that the bank, direct deposit intermediary, and financial outlet control the recipient's exempt funds, deducting fees, account charges, loan repayment and/or finance charges before the recipient gets control of her benefits. Taxpayer dollars intended to lift recipients out of poverty are skimmed off by banks and their partners as exempt funds are diverted to financial service providers at the expense of federal benefit recipients.

Direct Deposit Delivery of Exempt Funds through Check Cashers and Loan Companies

Four million or so unbanked Social Security and SSI recipients either receive their benefits as paper checks that must be cashed or through electronic deposit at their local check casher, loan company, or payday lender. Recipients who just get a paper check in the mail pay a high cost just to cash the check. On average, check cashers charge 2.44 percent of the face value of a government benefit check to cash it. For a $1,002 SS check, a recipient pays $24.45 a month or almost $300 a year just to turn the check into cash, according to a 2006 survey of check cashers conducted by CFA.[6] It costs even more to get direct deposit of benefits routed through financial outlets.

As Treasury and the Social Security Administration urged recipients to get their benefits through direct deposit, check cashers and a few banks came up with products that permitted them to hold onto this segment of their business. According to the check cashing trade group, seven percent of their customers reported using Social Security benefit payment services in 2006, up from three percent in 2000. Over three-fourths of these recipients reported accessing the payment service at a check cashing outlet.[7]

Master/Sub Account Direct Deposit of Exempt Funds Costly to Recipients

In Appendix A, we describe in detail the direct deposit products targeted at federal benefit recipients by four banks, their intermediaries and the check cashers, loan companies, and other outlets where recipients go to pick up their checks. Here is how this process typically works:

Banks set up a master account to receive exempt funds in the name of the recipient. The beneficiary goes to the check cashing outlet and pays to receive and then cash the "check" printed to deliver their funds or to have funds loaded onto a prepaid debit card. Fees are charged to set up the account, to deliver each payment, and to cash each check. The direct deposit accounts offered by check-cashers simply

[6] Jean Ann Fox, and Patrick Woodall, "Cashed Out: Consumers Pay Steep Premium to 'Bank' at Check Cashing Outlets," Consumer Federation of America, November 2006.

[7] Patricia J. Cirillo, Cypress Research Group, "Survey of Key FiSCA Member Organizations on Transaction Volumes," Attachment 1, October 2007, slide 20.

convert the electronic payment of benefits back into a paper check. When the benefits are delivered by debit card, recipients are provided a stored value card which appears to be not covered by Reg E protections which provide limits on liability for unauthorized transfers, procedures to resolve disputes, disclosures, and other substantive protections.

Recipients who are enrolled in these third-party direct deposit accounts have no direct control over their funds. The bank deducts its fees and those paid to the check casher or other entity that delivers the "check" or provides the debit card. Contracts include fine print that permits the bank to channel exempt funds to make loan payments on behalf of the recipient before handing over the rest of that month's check. Recipients get what is left over.

Some of the direct deposit bank/intermediary accounts and debit cards come with credit features of their own that are repaid out of exempt funds as first priority. Cash advance or overdraft loans tied to direct deposit of exempt funds into master/sub accounts appear to violate SSA requirements against assignment of benefits to pay debts.[8]

A Philadelphia SSI recipient who received $579.40 per month only received $566.50 in a cashier's check each month after the bank deducted $9.95 per month for the direct deposit account plus $2.95 to the check casher for printing out the check. Then the check casher charged its fee to turn that check into cash. The River City Bank Dollar$$$ Direct account came with a credit feature. For a $200 cash advance, the bank deducted $20 in finance charges, handing over a $180 cashier's check for the loan plus a check for the SSI benefits. Each month the bank collected payment in full by deducting $200 from his exempt funds, leaving him short. The loan was renewed for thirty-three months, with the SSI recipient paying $660 for the use of $180 for less than three years.[9]

Several of the bank/intermediary direct deposit programs market themselves to loan companies as a way to collect loan payments out of exempt funds.

Republic Bank & Trust/Currency Connection promotes its service to loan companies to "enhance(s) collection efforts for in-house lending."[10] The RB&T contract states, in part, "You agree that the Bank may, unless prohibited by law, debit funds from your Account to pay all or portions of any amounts you may owe the Bank or your EFI . . . Upon Account closure, the Bank will return to you the available balance in your Account less any fees or charges, claims, set-offs, or other amounts you owe the bank or EFI."[11]

- River City Bank Dollar$$$ Direct agreement states: "I further authorize the Bank to pay all of the fees and charges due to the EFD upon receipt by the Bank of the Direct Deposit."[12] The bank's Cash Advance Program makes loans of $200 to recipients that are repaid in full out of the next deposit of exempt funds. The bank charges a $10 fee and permits the EFD to also collect $10 for a one-month $180 loan.[13]
- First Citizens Bank/FirstNet/Cornerstone Community Bank is the direct deposit provider in the WSJ account of Mr. Bevel's loan payments out of exempt funds. FirstNet describes the benefits of its Government Benefits Processing for loan companies. "The process allows you to provide a safe, secure way for your customers to receive their benefits and **make their monthly loan payment as soon as the benefits become available**."[14] (Emphasis added.)

Treasury Failed to Protect Recipients

When EFT'99 was initiated, Congress directed Treasury to adopt regulations to ensure that federal recipients who were required to get direct deposit of benefits would be protected. Accounts were to be at financial institutions with access to accounts at a reasonable cost and with the same consumer protections as other ac-

[8] SSA, POMS, GN 02402.045.B, *Direct Deposit and Assignment of Benefits.* A request for direct deposit that assigns or transfers the right to future payment to someone other than the beneficiary is an assignment of benefits.

[9] River City Bank account summary, dated March 9, 2006 for client of Philadelphia Community Legal Services, on file with CFA.

[10] https://www.ccrbt.com/check_products.aspx, "Benefits to Check Casher."

[11] ACE CheckDirect Deposit Account Application and Agreement, acquired 2008, on file with CFA.

[12] River City Bank Dollar$$$ Direct Application, Authorization, Certification, Agreement. On file with CFA.

[13] River City Bank—Dollars Direct page, retrieved by Google on February 9, 2006. On file with CFA.

[14] https://www.weballotments.com/fedsys.asp, visited June 12, 2008.

count holders at the same financial institution.[15] Treasury's regulations governing the direct deposit system require that benefit payments may be deposited only into accounts at a financial institution in the name of the recipient.[16] Master/sub account arrangements do not meet those requirements under the EFT statute or Treasury's regulation.

In 1999 Treasury issued an ANPRM to request comments on regulating access to federal benefits through payment service providers. Despite extensive comments from consumer organizations, no further consideration was given by Treasury, at least in any public forum, to protecting this nation's most vulnerable recipients of federal benefits from the greed and opportunism of financial providers. Treasury has the authority to prohibit financial institutions accepting electronic deposits of federal payments from contracting with payment service providers to be conduits for the delivery of federal payments. Treasury adopted such a prohibition when it established Electronic Transfer Accounts.[17] Inexplicably Treasury failed to extend that same protection to recipients who were sold direct deposit services by check cashers, loan companies, and other retail outlets.

Payday Lenders Get First Claim to Exempt Funds in Bank Accounts

Banked federal benefit recipients are also vulnerable to high cost quick cash loans that extract exempt funds from consumers' bank accounts. As federal benefit recipients have acquired their own bank accounts to receive direct deposit from Treasury, they have also become eligible for loans based on checks/debits drawn on those accounts and held for future deposit. Since federal benefits are modest and payment is made on a monthly basis, many recipients struggle to make ends meet until the next check arrives at the first of the month.

Payday loans are small cash advances for less than $1,000, typically in the $300 to $500 range, based on holding the borrower's unfunded personal check or electronic debit for the amount of the loan and the finance charge. To get a payday loan, a borrower must have an open bank account, a source of income, and identification. Loans are due and payable in full on the borrower's next payday and typically cost 390 to 780 percent annual percentage rate (APR) for two-week terms. Finance charges are typically expressed as dollars per hundred borrowed, in the $15 to $30 per $100 range.

Payday loans are single payment balloon loans. On the next payday, a borrower can bring in cash and "buy back" the check, or the check can be deposited for payment, or the borrower can pay only the finance charge and renew the loan for another pay cycle without reducing the principal. Most checks written to get payday loans are never deposited and are bought back by customers who are then encouraged to take out another loan. Failure to bring in cash will result in the check/debit being deposited and exempt funds withdrawn from the account.

For more information on payday lending, please visit CFA's website for consumers: *www.paydayloaninfo.org*. Case studies on payday loan use by federal recipients are included in Appendix B.

Benefit Recipients Pay an Estimated $860 Million for Triple-digit Payday Loans

The payday loan industry projects $50.7 billion in annual loan volume through both storefront and online payday lenders, with $8.6 billion paid by consumers in finance charges.[18] The Colorado Attorney General's office reports that ten percent of payday loan customers list "benefits" as their source of income on loan applications.[19] This group of consumers includes recipients of state as well as federal benefits and pensions. Assuming Colorado is typical of payday lending in other states, "benefit" recipients' share of the payday loan market is $5 billion in loans, costing $860 million in finance charges. This may be a conservative estimate. The California Department of Corporations commissioned a study of payday loan customers in 2007. Over twelve percent of surveyed respondents listed a Government assistance check (General Relief/Social Security) as their first or second form of regular income.[20] The average borrower uses eight to twelve loans per year, becoming trapped

[15] 31 U.S.C. § 3332(i)

[16] 31 CFR 208.6, 210.5.

[17] 63 *Fed. Reg.* 64823 (Nov. 23, 1998).

[18] Dennis Telzrow and David Burtzlaff, "Payday Loan Industry: Industry Report," Stephens Inc. Investment Bankers, April 17, 2008 at 4.

[19] "Payday Lending Demographic and Statistical Information: July 2000 through December 2007," Administrator of the Colorado Uniform Consumer Credit Code, Office of Attorney General, February 4, 2008 at 3.

[20] California Department of Corporations—2007 Payday Loan Study, Applied Management and Planning Group, Table 27: Source of Paycheck or Regular Income for Respondent, page 46.

in repeat borrowing. All of the money paid to renew payday loans is diverted from meeting the basic needs of retirees, welfare recipients, veterans, disabled, survivors and dependents.

Payday Loans Modern Equivalent of a Wage Assignment

Securing payment of a debt by the borrower's unfunded check drawn on the next Social Security or other exempt federal funds to be deposited in the bank or by electronic authorization to access pay deposited into an account is the modern banking equivalent of a wage assignment. The Federal Trade Commission ruled decades ago that a wage assignment that could not be withdrawn was an unfair trade practice under the Credit Practices Rule. The FTC Credit Practices Rule outlaws credit contract provisions analogous to check holding, such as wage assignments, confessions of judgment, and the taking of a non-purchase money security interest in household goods. Holding the consumer's signed check is even more advantageous for a lender than holding a confession of judgment. With the check, the creditor goes directly to the bank to collect without filing suit or going to court to get a writ of execution. Since Federal policy is for federal payments to be direct deposited, a loan based on access to the funds that will be deposited into the account on the next payday is very close to a wage assignment.

The Electronic Fund Transfer Act prohibits conditioning the extension of credit on requiring electronic payment of debts for periodic payment loans, but is silent on the single payment electronic payday loan model. Typically an online payday loan can be renewed several times, with only the finance charge withdrawn from the account. Some of these payday lenders use remotely created demand drafts to collect directly from bank accounts when consumers exercise their rights to revoke access to accounts under the EFTA. Social Security and SSI recipients who sign these contracts lose control of the exempt funds in their accounts. For example:

CashNetUSA's Deferred Deposit Loan Agreement:

You promise to pay us the Total of Payments . . . You grant us a security interest in your ECheck/ACH Authorization in the amount of the Total of Payments (the "ECheck/ACH") which we may negotiate on the Payment Date or thereafter . . .

The ECheck/ACH Authorizations set forth in this Loan Agreement are to remain in full force and effect for this transaction until your indebtedness to us for the Total of Payments, plus any NSF fee incurred, is fully satisfied. ***You may only revoke the above authorizations by contacting us directly, and only after you have satisfied your indebtedness to us.***[21] (Emphasis added.)

Payday Lending Fosters Coercive Collection Tactics

Making loans based on holding unfunded checks until the next SS deposit arrives fosters coercive collection tactics. Some payday lenders imply, while others outright threaten, criminal consequences for failing to "make good" on the check used to get the loan. Some states, such as Missouri and Colorado, even impose criminal sanctions on payday loan borrowers who subsequently close their bank accounts or stop payment on the check used to get the loan. An incident in Virginia illustrates the problem.

- Donald and Gail Storer, an elderly couple in Virginia, both have serious medical problems and their only income is SSI. They borrowed $500 from a licensed payday lender and agreed to pay $75 per month in finance charges at an APR of 185%. After repeatedly renewing the loan, rising health expenses made it impossible for them to continue. A complaint filed on their behalf, Storer *v.* Buckeye Check Cashing of Virginia, Inc., alleged a "campaign of relentless harassment by the Defendant, a Payday Lender, which included specifically prohibited threats of criminal prosecution, in violation of the Virginia Payday Loan Act." A collector left a taped telephone message stating:

"This message is for Gail and Donald Storer. This is Check Smart calling again, Mr. and Mrs. Storer. We are not going away. We are going to continue calling, and eventually what is going to happen is our legal department is going to press charges against you. So I would pretty much try to call the Smithfield office to work out a time frame when you will be able to handle the matter at hand. The number is 757–365–9711. You are only hurting yourself."[22]

Table 54 noted that 9.1 percent of respondents were retired, the largest occupation listed besides "other."

[21] http://www.cashnetusa.com/secure/contract/contract, July 30, 2007.

[22] American Arbitration Association Award of Arbitrator, Re: 16 434 R 00441 07, Donald Storer and Gail Storer and Buckeye Check Cashing of Virginia, Inc., issued December 5, 2007.

The plaintiffs' SSI income was protected by federal law from assignment, levy, garnishment or other legal process.[23] The American Arbitration Association found that language threatening to "press charges" amounted to a threat of criminal prosecution and found that Checksmart violated the Virginia payday loan law.[24]

Veterans Are Not Protected from Payday Lending by Military Lending Act and DOD Regulations

In 2006 Congress enacted the Talent-Nelson amendment to the Defense Authorization act to protect Service members and their families from high cost lending that harmed readiness and damaged morale. Although it appears that active-duty service members are being protected from payday lending under DOD regulations that took effect October 1, 2007, veterans and non-active duty personnel are still fair game for 500% APR loans based on direct access to bank accounts into which military pay and exempt federal funds are deposited. The Navy Marine Corps Relief Society assists Navy and Marine retirees as well as active duty personnel. They report requests for assistance totaling $206,573 for payday loans from 145 retirees in 2007. That is up from the 115 retirees who requested help with $167,214 in payday loans during 2006.[25]

In order to protect veterans and retirees from triple-digit interest rate payday loans that directly access exempt funds deposited into their bank accounts, the protections of the Military Lending Act would have to be extended to all consumers. Those protections would stop loans based on personal checks held for future deposit or on electronic access to bank accounts as well as cap interest rates at 36% APR including fees.

Policy Issues and Recommendations

1. *The Social Security Administration* recognizes the problems caused by delivery of exempt benefits through master/sub account arrangements and requested public comment on a proposal to discontinue that arrangement. We filed comments to assist SSA, providing examples of Master/sub account providers as well as case studies of exempt recipient victims.
    - We respectfully request that this Committee give its strong support to terminating direct deposit of exempt funds by Social Security Administration through Master/sub accounts at financial service companies.
2. *Treasury failed to protect unbanked federal benefit recipients*. Because Treasury failed to enact regulations governing third party direct deposit of federal benefits ten years ago, consumers who most need protections get direct deposit of their exempt federal benefits through inferior, unsafe arrangements between a few banks and check cashing outlets, small loan companies and other storefront and online providers.
    - We urge the Ways and Means Committee to strongly recommend that Treasury complete its work under EFT'99 by protecting all federal benefit recipients from substandard and high cost bank account arrangements.
3. *Payday loans function as defacto wage assignments against exempt funds* which are supposed to be safe from attachment. It is especially important for Congress to safeguard tax-payer funded benefits that recipients have been mandated to receive by direct deposit into bank accounts.
    - We request that this Committee do everything in its power to protect all consumers from loans secured by unfunded personal checks held for future deposit or by required electronic debits to their bank accounts. A bill is pending in Congress that, if enacted, would protect SS and SSI recipients, veterans, and federal retirees from defacto assignment of benefits.[26]

Thank you. I would be glad to answer your questions.

Appendix A

There are at least four bank/intermediary services that offer direct deposit of federal benefits through check cashers, loan companies, money transmitters and other retail outlets.

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[23] Donald Storer and Gail Storer *v.* Buckeye Check Cashing of Virginia, Inc., d/b/a Check$mart, Complaint and Demand for Jury Trial, Circuit Court for Isle of Wight County, Virginia, filed with the American Arbitration Association on May 14, 2007.

[24] American Arbitration Association Award of Arbitrator, page 4.

[25] Dotty Clayton, Navy Marine Corp Relief Society, electronic communication to CFA, June 17, 2008.

[26] "Payday Loan Reform Act of 2007," HR 2871

1. Currency Connection/Republic Bank & Trust (RB&T) is a Direct Deposit Program marketed to check cashers and similar entities. Exempt federal funds are delivered to recipients either as cashiers checks or loaded onto a debit card. The RB&T program is targeted to consumers receiving payroll, government benefits (Social Security, SSI–Supplemental Security Income, VA–Veterans Affairs), child support, unemployment, retirement or any other regular direct deposit.

Currency Connection claims customers benefit by receiving payment two to four days earlier than payment is received by mail, by the safety of picking up the check rather than receiving a check in the mail, convenience in picking up the check where it is to be cashed, and FDIC insurance for deposits.[27] The benefits for check cashers are stated as: "Check cashers can ensure their customers will come back month after month with the Currency Connection DirectDeposit Program. Enroll in this FREE program to become a Republic Bank Electronic Funds Issuer and start increasing your customer retention and overall profitability."[28]

Currency Connection's *Cashier's Check* fees include $3 to Republic Bank for the 1st direct deposit per month, plus a $3 bank fee charged to customers for each additional deposit. The bank's partner Electronic Funds Issuer (EFI) can charge customers an additional $1 to $5 fee for printing a paper check to deliver the funds for a total of up to $6 per check in addition to the fee to cash the check. Currency Connection does not set limits on the fee check cashers can charge to then cash the paper check.

Currency Connection's *debit card* fees include $19.95 to set up the account and a monthly $19.95 service fee. ATM transactions at Republic Bank & Trust terminals are free, but RB&T charges $2 each time a customer uses another bank's ATM plus deductions are made for whatever the "foreign" ATM charges. Point-of-sale or balance inquiry fees are $1 each.[29]

Both the bank and the check casher/loan company gain direct access to deposited exempt funds to pay fees or make loan payments before the recipient has access to federally-protected funds for living expenses.

Currency Connection touts its service to loan companies to "**enhance(s) collection efforts for in-house lending**."[30] The contract signed by benefit recipients with RB&T authorizes both the bank and the EFI to withdraw funds from the deposit to repay obligations to either the bank or the check casher/loan company. The Agreement states:

You agree that the Bank may, unless prohibited by law, debit funds from your Account to pay all or portions of any amounts you may owe the Bank or your EFI. You acknowledge that the Bank may set-off against your Account in order to recover any ineligible benefits or payments you may have withdrawn if the Bank is obligated to return the funds to the entity that originates your payment ("Direct Deposit Originator"). Either you, or the Bank may transfer or close your Account at any time. Upon Account closure, the Bank will return to you the available balance in your Account ***less any fees or charges, claims, set-offs, or other amounts you owe the Bank or EFI.***[31] (Emphasis added.)

ACE Cash Express, a large check cashing/payday loan provider, has a private label version of Currency Connection, branded CheckDirect, which delivers Social Security, SSI, VA and retirement benefits via a cashier's check or a prepaid debit card.[32] Store fliers display an image of a U.S. Treasury Social Security, SSI and VA check: "Get your check up to three days earlier than by mail. Avoid the hassle of a lost or stolen check. Pick up and cash your check at over 1,000 locations offering ACE CheckDirect."[33] Ace check cashing fees vary, depending on state fee caps. A volunteer was told by an Arkansas ACE outlet that 2 percent is charged to cash the paper check generated from the Check Direct account. For a recipient receiving $800, it would cost $21.95 monthly just to access Social Security funds via CheckDirect ($3 RB&T fee, $2.95 for ACE to print the check plus $16 to cash the check.)

RB&T Currency Connection Debit Card Program also provides an optional "Overdraft Protection" Feature which turns the direct deposit delivery card into a credit

[27] https://www.ccrbt.com/check_faqs.aspx, last visited February 14, 2008.
[28] https://www.ccrbt.com/check_products.aspx, last visited February 14, 2008.
[29] http://www.ccrbt.com/card_fazs.aspx, last visited June 11, 2008.
[30] https://www.ccrbt.com/check_products.aspx, "Benefits to Check Casher"
[31] ACE CheckDirect Deposit Account Application and Agreement, acquired 2008, on file with CFA.
[32] http://www.acecashexpress.com/ss_directdeposit.php, last visited February 14, 2008
[33] ACE CheckDirect flier, picked up at Arkansas outlet, February 2008. On file with CFA.

instrument.[34] Currency Connection Overdraft $hield fees cost 25 percent of each overdraft per payment period up to a maximum of $100. It is available to Currency Connection customers who receive at least $400 per payment deposited into Republic Bank & Trust. **A Social Security recipient who elected the Overdraft feature would be charged at least 300% APR for a cash advance**, assuming the loan was outstanding for a full month. A recipient who overdrew on the card a week before the next SSI deposit was due would pay 1,300 percent APR ($25 per $100 borrowed for one week). Overdraft loans are repaid out of the next deposit into the account.[35] This gives the bank first claim on exempt funds.

Recipients can also borrow from RB&T when their funds are delivered via cashier's check. The standard Currency Connection Cashier's Check which is generated by the non-bank partner includes a Truth in Lending box to disclose the amount financed, the finance charge, total of payments, and the Annual Percentage Rate. Fine print states that borrowers will not be entitled to a refund of any part of the prepaid finance charge.[36]

2. Dollars Direct (River City Bank)

River City Bank of Kentucky offers a direct deposit program to check cashers through its Dollar$$$Direct program. The bank's marketing materials to check cashers explain:

Only banks can offer direct deposit. UNTIL NOW!

Now YOU can offer direct deposit to your customers! The Dollar$$$Direct program makes it possible for these "unbanked" individuals to continue receiving and cashing their checks while complying with the government's wishes to go paperless . . . You can establish a check printing fee from $0—$9.99 for each check that you print. Also, providing direct deposit will keep your customers coming back to you each and every month![37]

River City Bank Dollar$$$Direct delivers exempt funds by either a cashiers check or a debit card. The direct deposit agreement permits the bank to deduct fees for both River City Bank and the Electronic Funds Distributor (EFD) before exempt funds are made available to the recipient.[38] Once the funds have been transferred from the bank to the check casher or other outlet, the bank takes no responsibility for failure of their partner to correctly deliver the check to the payee.[39]

Fees and charges: I authorize the Bank to deduct from the proceeds of my monthly or other periodic disbursement, all fees and charges related thereto as described in the Dollar$$$Direct account disclosures and fee schedule. I further authorize the Bank to pay all of the fees and charges due to the EFD upon receipt by the Bank of the Direct Deposit.[40]

[34] http://www.electrobanking.com/users/serview.asp?xss'ElectroBanking&suid'515&page' . . . Last visited April 29, 2008.

[35] AMsource Currency Connection FAQ, on file with CFA.

[36] *Id.*

[37] http://www.dollars-direct.com/visited May 2, 2006.

[38] "Fees and Charges: I authorize the Bank to deduct from the proceeds of my monthly or other periodic disbursement, all fees and charges related thereto as described in the Dollar$$$ Direct account disclosures, and fee schedule. I further authorize the Bank to apply all of the fees and charges due to the EFD upon receipt by the Bank of the Direct Deposit." CITE

[39] Application-Authorization-Certification-Agreement, Terms and Conditions of the Account, Deposits and Withdrawals, accessed at http://www.debitcardone.com June 16, 2008. "I hereby appoint the EFD as my agent for purposes of receiving from the Bank and delivering to me my monthly or other periodic check(s). I hereby release, absolve, and forever discharge the Bank from any and all liabilities whatsoever as a result of (e) the failure of the EFD to deliver my monthly or other periodic check(s) to me; or (ii) the fraudulent endorsement or negotiation of my monthly or other periodic check(s). In the event of the occurrence of the events described at (i) and (ii) of this paragraph, I acknowledge that the only claims I have are against the EFD, and not the Bank."

[40] River City Bank Dollar$$$Direct Application, Authorization, Certification, Agreement. On file with CFA.

The Dollar$$$Direct fee schedule includes the following:

Account Setup Fee	$14.50
Cashier's Check Fee	$2.95 (for each check issued for first deposit) $1.95 (for each subsequent payment deposited)
Dollar$$$Direct Debit Card	
Monthly Service Charge	$10
Transaction fee	$1
Overdraft Privilege Fee	$7.50 [41]
Cash Advance Fee	$10

Dollar$$$Direct's debit card comes with an overdraft "privilege" of up to $250 over the account balance,[42] enabling recipients to borrow from the bank by overdrawing the account. A River City Bank web page cached by Google from February 9, 2006 explains its cash advance program to check cashers and other outlets as a loan product.

Welcome to the Cash Advance Program page. Here you will find information about how direct deposit customers can get Cash Advances on any benefit or payment including SSA, SSI and VA as well as Payroll and Welfare.

What is CAP?

The Cash Advance Program or CAP is a program within the Dollar$$$Direct program where an EFD (Electronic Funds Distributor) is allowed to print and distribute Cash Advances taken on any recurring payment received by a direct deposit customer. An EFD can offer money anytime to direct deposit customers who simply cannot wait until their next deposit arrives. If the customer qualifies, he or she could receive part of their direct deposit whenever they need it.

Offering Cash Advances to your customers will increase your check printing and cashing volume. Cash Advances are only available as $200 loans from River City Bank. The bank charges a $10 fee for each Cash Advance, and we can deduct up to $10 per Cash Advance for your fee as well. Offering CAP could also increase your customer base ***since some customers are more interested in the Cash Advance option than they are the direct deposit option.*** Finally, offering CAP through our program relieves you of the risk involved in loaning funds."[43] (Emphasis added.)

Dollar$$$Direct agreement permits one cash advance per direct deposit. The APR quoted for a one week loan is 277.44%, and for 28 days as 68.61% APR. If the check casher adds an additional $10 fee per $200 loan, the cost of this loan doubles to 554.88% APR for one week and 137.22% APR for 28 days. The APR disclosure the customer sees prior to getting a loan does not include other fees which could be charged by the bank's store front partner. To get a cash advance, the borrower has to sign over the next direct deposit of exempt federal funds to the bank. The agreement states:

I authorize the bank to access the designated Direct Deposit Account once the direct deposits have been made into the Direct Deposit Account and to disburse the monies deposited therein (less all applicable loan payoffs, fees and charges) as a cashier's check made payable to me.[44]

3. Petz Enterprises Quick Acce$$** advertises to check cashers that "Giving Money Away has Never Been So Profitable . . . .The majority of your check-cashing customers come to you because they don't have a checking account. QuickAcce$$ allows you to print and cash payroll and benefits checks all in one place, giving your customers the speed and security of direct deposit without having to use a conventional bank while **you get to keep a percentage of every transaction (emphasis

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[41] http://www.debitcardone.com/terms.html, June 16, 2008. Fee schedule dated 09/03. A version provided by Community Legal Services in Philadelphia, dated 04/07, did not list the Overdraft Privilege Fee, but included a $10 Cash Advance Fee. On file with CFA.

[42] http://www.debitcardone.com/features.html, visited June 16, 2008.

[43] River City Bank—Dollars Direct page, retrieved by Google on Feb. 9, 2006. On file with CFA.

[44] River City Bank—Dollars Direct Agreement, Cash Advance Product, on file with CFA.

in ad.)"[45] In a 2005 Petz newsletter, the QuickAcce$$ 2004 program was described as follows: "QuickAccess allows your customer's funds to be directly deposited into a trust account, and you are authorized to print a check made payable to the recipient at your location for the amount of the benefits, less any applicable QuickAccess fees."[46]

QuickAccess partners with Bank of Agriculture and Commerce in California to receive direct deposit of SS and SSI benefits. Their electronic benefit distribution method is advertised to check cashers, grocery stores, convenience stores, and pawn brokers. Types of benefits processed include Social Security payments, retirement benefits, and payments from more than 27 Federal Entitlement Programs. QuickAccess transaction fees to retail service centers are $3 per check for all transactions greater than $10 with no fee for smaller transactions. Retailers are charged $195 Annual Membership Fee per location with the fee waived for locations with more than twenty-five registered recipients. QuickAccess pays rebate bonuses to service centers of up to fifty cents per check based on monthly transaction volume.[47] We do not have a fee schedule for charges to benefit recipients for receiving their SS or SSI payments at check cashers or other retailers using QuickAccess.

4. First Citizens Bank/FirstNet/Cornerstone Community Bank. In the Wall Street Journal example of Mr. Bevels and the Small Loan Company in Alabama, SSA deposited his exempt federal funds into an account at Cornerstone Community Bank in Chattanooga, TN. Mr. Bevel's funds were immediately deducted to make payments to the Small Loan Company. The bank statement directed inquiries to a phone number for First Citizens Bank's FirstNet operation based in Radcliff, KY. First Citizens Bank describes its "Federal Benefits Program" direct deposit service for loan companies as follows:

"FirstNet pioneered the first third-party federal benefits payment processing system for the consumer finance industry in 1992. This system allows companies operating as Financial Service Providers to accept and process direct deposits on behalf of federal benefit recipients. This system can also be used for anyone using direct deposit, including non-federal benefits. This service has proven to be beneficial in increasing branch traffic, increasing processing fees, and building customer loyalty. Industries successfully using this: Consumer Finance, Money Transfer. Key Benefits: Increased branch traffic. Increased fee revenue. Availability of funds on opening of business on beneficiary pay date. Flexible movement of funds. Automatic electronic enrollment."[48]

FirstNet's website further explains the benefits of its "Government Benefits Processing" for loan companies. "The process allows you to provide a safe, secure way for your customers to receive their benefits and **make their monthly loan payment as soon as the benefits become available**. (Emphasis added.)"[49] The social worker who assisted Mr. Bevels recalls that he had multiple loans at the same loan company, each permitting the loan company's bank to deduct loan payments from his exempt funds, leaving him with about $200 from the $600 monthly check to live on.[50]

Appendix B

Case Studies of Federal Beneficiaries and Harmful Financial Products and Practices

- A Houston, Texas Social Security recipient borrowed $360 from Cash Express and its True Financial Services, LP partner in a "credit services organization" (CSO) form of payday lending. Finance charge for this loan was $75.25 ($3.25 interest to True Financial and $72 fee to CSO) and the APR 231.20 percent. The loan was issued on August 31, 2007 and was due in full on October 3, 2007 for a payment of $363.25 due to True Financial Services, LP and $72 on the same day to Cash Express for its CSO fee. He paid $72 every month for six months, thinking he was paying down the loan. After paying $432 back on a $360 loan, he was told that he still owed the full $360 amount for loan principal and another CSO fee. The loan was secured by authorization to permit the lender to withdraw funds through the automated clearinghouse

[45] QuickAcce$$ ad, *Checklist,* Vol. 10 No. 3, 2007, p. 62.
[46] Petz Enterprises Newsletter 2005 "What's Better than Money in the Bank?" available at www.petzent.com.
[47] http://www.petzent.com/quickaccess/pricing.asp, last visited May 22, 2008.
[48] http://www.first-citizens.com/allot.asp?IF'fedben.asp&FTR'altfooter.asp, last visited May 22, 2008.
[49] https://www.weballotments.com/fedsys.asp, visited June 12, 2008.
[50] Telephone communications with social worker

system from his bank account. The contract language does not permit the borrower to terminate the ACH authorization:

Automated Clearing House ("ACH") Authorization. You agree to provide us ACH authorization to debit your checking account ("Account") at your bank ("Bank"). If you do not pay us on time, either directly or in care of the CSO, you authorize us or our agent, to initiate an ACH debit to your Account for any amount due to us with regard to this loan. You are not authorizing us to initiate ACH debits on your Account to recur at substantially regular intervals. However, Lender or its agent may resubmit an ACH debit up to three times if the debit is not honored by your Bank. You will maintain a balance of available funds in your Account at least equal to the amount due and owing under this Agreement. You understand that your Bank may impose charges for each ACH debit that is not honored by your Bank. You agree that an ACH debit authorized under this Agreement may be combined with an ACH debit that you authorized your CSO to make with regard to your loan.[51]

- A Berea, KY consumer, whose sole income was a $475 to $620 monthly SSI benefit for disabilities, got payday loans costing 180% APR and check cashing services from Cash Express LLC. She was required to furnish a post-dated check for the amount of the loan plus the fee. The lender knew that the $460 loan check constituted more than eighty percent of the borrower's monthly income, making it likely that loans would be renewed or rolled over on a monthly basis. According to a complaint filed in arbitration, she paid the $60 finance charge and rolled over the principal numerous times. The monthly fees alone were about ten percent of her income. She became unable to pay her rent and was evicted from subsidized, Section Eight housing on which she paid rent of $118 a month. Storage for her furniture cost $75 per month. Eventually she closed her bank account and offered to make $25 monthly payments on her $500 debt to Cash Express. During a visit to discuss payment arrangements, Cash Express offered to cash her SSI check for a fee. The lender refused to return any funds to the consumer, keeping all of her cashed SSI check to pay on the loan, leaving her with no income for the month. This caused extreme emotional distress.[52]
- A Franklin, New Hampshire resident whose only income was from SSI, got a loan from Advance America, expecting to be able to repay the loan with SSI funds after the town welfare office helped with her living expenses. The $350 loan for one month cost $70 finance charge and 240 percent APR. When assistance was denied, Advance America refused to provide an extended payment plan. She stopped payment on the check used to get the loan and offered to make $5 payments. Advance America staff visited her home to demand payment and made repeated telephone calls demanding payment. Despite accepting her $5 payments, Advance America told her to stop sending the payments and that they would take her to court if she didn't pay in full. Only after a legal services attorney explained the exempt status of SSI funds and the terms of the New Hampshire debt collection law did calls stop.[53]
- A Colorado consumer "GM" posted a message to the Arkansas coalition opposing payday lending (www.StopPaydayPredators.org). GM had twelve payday loans open at the same time. He paid interest-only fees until no longer able to do so and was being accused of writing checks on a closed account. His only income is SSI and Social Security benefits. He stated he was "extremely terrified because I know that I won't survive in prison" and saw homelessness as his only way to repay the twelve loans.[54] Colorado permits payday lenders to charge $20 per $100 for the first $300 loan and $7.50 per $100 for loan amounts from $300 to $500. A two-week $300 payday loan costs 520% APR.[55]
- Peter Dixon, a disabled Virginia resident, whose sole income consists of Social Security Disability Insurance Benefits of about $700 per month, got payday loans from NFC Payday Advance in Danville. To borrow $300, Mr. Dixon wrote an unfunded check for $345 for a 30-day loan at an APR of 219%. He paid NFC $45 per month in interest on the original $300 loan. At the end of twenty months, he had paid $900 in interest for $300 principal borrowed

[51] Loan Disclosure and Promissory Note, True Financial Services, LP, on file with CFA

[52] Complaint, Riva Banks vs. Cash Express of Tennessee, LLC d/b/a Cash Express LLC, American Arbitration Association in the Commonwealth of Kentucky, filed December 27, 2007.

[53] Electronic communication, Sarah Mattson, New Hampshire Legal Assistance, received by CFA June 2, 2008.

[54] Electronic communication from H.C. Klein, on posting at www.StopPaydayPredators.org Feb. 24, 2008.

[55] See State Information, www.paydayloaninfo.org Click on Colorado on the map for details.

but still owed the original balance. In order to pay off the $345 owed, Mr. Dixon got another payday loan and sold a vehicle.[56]

- Cynthia Wimberly, who was unemployed and had no income, obtained payday loans from Advance America in Arkansas, secured by the Veterans Administration and Social Security benefits provided to her granddaughter. She was charged 150.30% APR for one-month loans which were repeatedly renewed for interest-only payments. When she asked for an extended payment plan to retire the debt, Advance America refused. Nehemiah Bailey, another Arkansas consumer whose only income came from Veterans Administration benefits borrowed $350 and agreed to repay $390.37 by the end of the month for a loan costing 150.35% APR. The Advance America contract granted the lender access to funds deposited in the borrowers' bank accounts. If borrowers did not return to the store to "repurchase" the check with cash, the lender would deposit or present the check at a bank to be repaid from funds on deposit in the borrower's account.[57]

Appendix C

Social Security and SSI Beneficiaries Cannot Afford Payday Loans

Consumers who rely on Social Security or SSI or VA benefits for most or all of their income simply cannot afford to repay the typical payday loan in a single monthly balloon payment. A retiree with $25,000 in annual income and typical expenses based on the 2006 Bureau of Labor Statistics budget for people in the $20,000 to $30,000 per year income range would have a deficit of $158 after repaying a $325 payday loan at the end of the month. This income category would apply either to one recipient who gets about half her income from Social Security and half from another source or for two recipients who only receive Social Security. About two-thirds of retirees get half of their income from Social Security, making this scenario fit the majority of SS recipients.

$25,000 per Year Income Not Sufficient to Repay Payday Loan[58]

Income: Monthly income before taxes	$2,083
Household Expenditures per month	
Food	345
Housing/utilities	896
Transportation	422
Healthcare	201
Total Expenditures:	1,864
Net Paycheck minus essentials:	219
Average Payday Loan	325
Average Payday Loan Payment with Interest	377
Monthly Deficit if payday loan paid on time	**$-158**

Mr. POMEROY. Thank you very much.

[56] Complaint, *Peter Dixon* v. *NFC Check Cashing Services, Inc., d/b/a NFC Payday Advance,* Circuit Court for the City of Danville, on file with CFA.

[57] Complaint, *Kelvin White, Cynthia Wimberly, and Nehemiah Bailey vs. Advance America Servicing, et al,* Circuit Court of Ouachita County, Arkansas, May 31, 2007.

[58] Analysis by Leslie Parrish, Center for Responsible Lending. http://www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/2007/fast_facts07.html and http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/and Bureau of Labor Statistics Consumer Expenditure Survey 2006.

I think Dallas, we will take your testimony, and then we will proceed to vote. Dallas, being a very experienced witness, knows that the five-minute rule will allow us still time to hear you out, and get over to vote. Thank you.

STATEMENT OF DALLAS L. SALISBURY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. SALISBURY. Chairman Pomeroy, Ranking Member Brady, Members of the Committee, thank you for having me today.

Since first working on these issues at the Department of Labor in 1975, I regret that, in spite of dramatic advances in technology, education, delivery, and financial services, issues related to financial literacy of our population have grown greater, rather than declined.

I was asked today specifically to speak to issues of financial literacy and financial education. People do tend to make bad choices with their money. One of the questions asked—and, as you well know, an entire field of psychology, and otherwise termed "behavioral finance" has developed in recent years to answer the question. What, consistently, that work says in its simplest form is that people prefer immediate gain, they prefer immediate gratification, they focus most readily on the short-term, and are highly subject to messages and the way they are framed.

Individuals, in short, prefer to be sold, and to be given the easy route. When these factors are taken into consideration against the substantial documentation of low financial literacy among all age groups, it makes bad decision-making, and people being taken advantage of, quite understandably.

Thus, individuals become victims of predatory lending, choose to pay high check-cashing or lending fees that they may not understand, or make bad choices when they have choices, in terms of financial management. Advances such as EFT–99, seeking to solve the problem called "the unbanked," of which there are still another 40 million in this country, end up creating secondary difficulties, the subject of this hearing today.

I also was asked to provide an overall assessment of financial literacy in our nation today. It's been well documented that financial literacy in the population is very low. This is especially true and is true across all demographics, even though we do find higher rates as education and income increases.

As a result of the termination, interestingly, of home economics classes in our schools in the 1970s, far fewer individuals receive financial literacy education in our nation than they did in the 1950s, 1960s, and 1970s. Our surveys indicate that, while 80 percent of high school students are offered the opportunity for financial literacy education, only 8 percent choose to take it.

It is this absence of financial literacy education at the earliest ages that used to be provided on a mandatory and common basis that likely underlines why the JumpStart Coalition's 31-question survey of youth financial literacy revealed lower literacy among seniors high school last year than in the prior 5 years. There is a lot of learning, if you will, that needs to be done.

Other surveys find that an amazing low percentage of the population actually understands the concept of compound interest. That's the positive kind, when you're earning it. Even fewer understand it when it is applied to such things as credit card debt or interest on fees.

The financial literacy of seniors, including what we know about how they make decisions is also not encouraging. A recent survey by AARP found that among those 50 and over, Americans are befuddled by financial jargon, confusion results in doubts, missteps, and lost opportunities, and Americans believe the financial services industry does a poor job of communicating.

Everyone here, I'm sure, in a recent prescription has received the lengthy document that describes all of the pharmacology. I was amazed in that AARP survey that 96 percent of the population said they found that easier to understand than the mutual fund prospectus they were shown.

The AARP bulletin also recently commissioned a nationwide poll to examine financial literacy on consumer subjects for those above 50. Fifty percent of poll respondents failed the financial literacy quiz, meaning they could not get at least half the questions right. My testimony goes into many of those findings.

The Employee Benefit Research Institute that I helped found in 1978 has now done 18 successive retirement confidence surveys, which include special surveys of those over age 65. Those surveys underline that individuals have relatively low understanding of many of the topics important to them. Ironically, they have very high confidence in Social Security and Medicare, in spite of some of the fiscal challenges faced.

The important protection Social Security provides beneficiaries, such as my mother, who next month will turn 92 and, Congressman Brady, is one of those that relies exclusively on Social Security for income, these are especially important issues.

In conclusion, there are many partnerships out there, many activities out there, that are seeking to educate seniors. The Federal Government has been central to many of them. There is much more that could be done. The data on financial literacy across the population underlines its necessity. Thank you very much for having me.

[The prepared statement of Mr. Salisbury follows:]

Prepared Statement of Dallas L. Salisbury, President and Chief Executive Officer, Employee Benefit Research Institute

Chairman McNulty, and Members of the Subcommittee on Social Security of the Committee on Ways and Means, I thank you for the opportunity to provide testimony on this important topic. Since first working on related issues at the U.S Department of Labor in 1975, I regret that in spite of dramatic advances in technology, education delivery, and financial services, issues related to the financial literacy of our population have grown greater, not declined. I am pleased to comment on the specific questions sent to me by the Committee.

- **Why do people make bad choices when it comes to their money?**

An entire field of psychology and behavioral finance has developed in an effort to answer this question (see http://en.wikipedia.org/wiki/Behavioral—finance). Put it its simplest form, people prefer immediate gain and gratification, focus most readily on the short term, and are highly subject to messages and the way they are framed. Individuals prefer to be "sold."

When these factors are taken into consideration against the substantial documentation of low financial literacy among all age groups, it makes bad decision-making understandable.

Thus, individuals become victims of predatory lending practices, choose to pay high check cashing or lending fees when they have other choices, or make bad choices when they have choices in terms of financial management. They frequently make choices from among what they think they know or are presented with, rather than undertaking a search on their own. Behavioral research also finds that they prefer making choices from a narrow set of options, as opposed to a wider set.

Many individuals at lower income levels may not have a choice in cases where they have little or no income and/or face emergencies. These individuals face desperation and make choices that allow them to survive today, regardless of the longer-term consequences.

- **Your overall assessment of the financial literacy of our nation and whether there are significant variations between certain demographic groups.**

It has been well-documented that financial literacy in the population is quite low. This is essentially true across all demographics, even though we do find higher rates as education and income increase. As a result of the termination of most "home economics" courses in our public schools, we provide a lower rate of mandatory financial education today than in the 1970s and earlier. Nearly 80% of our young are offered elective opportunities for financial education, but our surveys indicate that fewer than 8% choose to take the courses.

The 31-question Jump$tart Coalition's biennial survey of youth financial literacy survey revealed that high school seniors have a lot to learn about important financial concepts. Among the findings in the survey:

- Forty-eight percent correctly said that a credit card holder who only pays the minimum amount on monthly card balances will pay more in annual finance charges than a card holder who pays their balance in full.
- Seventeen percent correctly answered that stocks are likely to yield higher returns than savings bonds, savings accounts and checking accounts over the next 18 years, even though there has never been an 18-year period where this wasn't true.
- Forty percent correctly answered that they could lose their health insurance if their parents become unemployed.
- Thirty-six percent think a house financed with a fixed-rate mortgage is a good hedge against a sudden increase in inflation, compared with 45 percent in 2006.

An amazingly low percentage of the total population actually understands the concept of "compound interest," and this includes not understanding it when it applies to the interest you will have to pay on a loan or your credit card.

- **The financial literacy of "seniors," including what we know about how they make their decisions, is also not encouraging.**

A recent survey by AARP found among those over 50 that:

- Americans are befuddled by financial jargon.
- Confusion results in doubt, missteps and lost opportunities.
- Americans believe the financial services industry does a poor job of communicating.

The AARP Bulletin recently commissioned a nationwide poll to explore financial literacy on important consumer subjects among people ages 40 and older. Fifty percent of the poll respondents "failed" the financial literacy quiz, meaning they could not get at least half the questions right.

Additional findings include the following:

- ***Medicare coverage.*** Less than one-third (31%) of the respondents correctly identified all of the items that Medicare does not cover.
- ***Car buying regrets.*** Nearly two-thirds (63%) of the respondents incorrectly stated that federal law allows one to cancel a car purchase within three days if it was bought at a car dealership.
- ***Bankruptcy.*** Roughly one-third (32%) of the poll respondents correctly reported that bankruptcy is growing faster amongst Americans age 65 and older than any other age group.
- ***Social Security benefits.*** Only 32% of the respondents correctly reported that a person of full retirement age or older may keep 100% of his Social Se-

curity benefits even if he is currently employed, regardless of how much he earns at his current job.

The Retirement Confidence Survey® includes results for the population over age 65. Over the 18 years that this survey has collected data, confidence in having enough money to live comfortable throughout retirement has changed very little overall. Confidence in Medicare and Social Security continuing to provide benefits of equal value in the future has risen. Savings among those over 65 have remained well below the value of Social Security benefits for the vast majority, with declines in recent years. Forty-four percent reported this year that they are more concerned about their financial future than before they retired. While these measures do not speak to financial literacy per se, they do speak to the reliance seniors place on continuation of public programs at current levels. This also suggests the education challenges facing the public sector in the future.

- **Any information you can provide about what efforts are being tried in both the public and private sector and what works.**

Numerous campaigns are underway that specifically relate to our nation's seniors, with resources at web sites such as these:

§ Financial Literacy Public-Private Partnership (FLPPP) http://www.dfi.wa.gov/flppp/seniors.htm
§ Financial Literacy for Older Adults http://www.albany.edu/aging/fl/resources/pres-financialliteracy.pdf
§ Seniors Protecting Themselves from Securities Fraud http://www.asc.state.al.us/InvestorED/-3-04SeniorsTakeControlPortrait.pdf

Overall, research finds that individuals seek the path of least resistance, and respond to sales efforts. As a result, many people become victims of predatory lending practices, choose to pay high check cashing or lending fees when they have other choices, and make bad choices when they have choices in terms of financial management.

For many, the 2007 National Risk Behavior Study found that fraud was most common when individuals:

1. Rely on friends, family and co-workers for advice.
2. Are open to 'new' investment information and attending free seminars.
3. Fail to check on the background of the person doing the selling.
4. Are unable to spot persuasion tactics used by con men and women.

One program that I have been involved with as a member of the Board of the FINRA Investor Education Foundation provides information at www.SaveAnd Invest.org

Table 1

HI Income Shortfall and SMI General Revenue Contribution
(Billions of Dollars)

Calendar Year	HI Trust Fund Income[1]	HI Trust Fund Expenditures	HI Trust Fund Shortfall	SMI Trust Fund General Revenue Contribution[2]	HI Income Shortfall Plus SMI General Revenue Contribution
2007	$207.1	$203.1	-$4.0	$178.4	$174.4
2008	204.8	229.5	24.8	186.2	211.0
2009	230.9	245.5	14.6	208.4	223.1
2010	243.0	260.5	17.5	192.3	209.7
2011	255.4	276.0	20.6	217.5	238.2
2012	268.1	294.7	26.6	234.9	261.4
2013	282.0	315.6	33.6	258.2	291.8
2014	296.2	337.8	41.6	273.3	314.9
2015	310.5	361.4	50.9	313.9	364.8
2016	325.7	386.8	61.1	302.2	363.3
2017	341.7	414.9	73.1	353.3	426.4
Total 2008-2017	$2,758.3	$3,122.8	$364.5	$2,540.0	$2,904.5

[1] HI receipts exclude interest income.
[2] SMI general revenue contribution includes Part B and Part D general revenue contributions.
Source: American Academy of Actuaries' tabulations based on 2008 Medicare Trustees' Report Tables III.B4 and III.C1 (Intermediate Projection).

Working with the SEC, the State of Washington, and the AARP, a pilot investor protection campaign for older investors has just been completed. This work has found that *Direct education on fraud risk behaviors, social influence tactics and prevention strategies—such as asking questions and checking registration status of the professional and the investment—can reduce investment fraud susceptibility.*

§ Interviews of con-artist criminals reveal that they do not like to be questioned.
§ Call center research found that providing fraud targets with questions they could ask produced the largest reduction in victimization rates.
§ Older investors who received a workshop on outsmarting investment fraud and influence tactics were 50% less likely to "open the door" to a fraudulent investment pitch by accepting additional communications.

Conclusion

The nation needs to continue to focus on increasing financial knowledge, providing meaningful consumer protections, and finding ways to protect vulnerable populations from fraud. Many good programs exist, but the absence of requirements for financial education in public schools underlines that the nation is missing opportunities—if financial literacy is an objective—even when it has "captive" populations.

As the FINRA coalition research found in 2007, high income and extensive education do not alone protect seniors from fraud. These are issues for the entire U.S. population.

Dallas Salisbury is president & CEO of the nonpartisan Employee Benefit Research Institute (EBRI) and chairman of American Savings Education Council. EBRI does not take policy positions and does not lobby. www.ebri.org

Mr. POMEROY. Thank you very much, Mr. Salisbury, and panel. It is a single vote. We will be asked to register how we feel about adjournment. We will get our daily stroll and come back and begin immediately with questions. Thank you.

[Recess.]

Mr. POMEROY. All right, we will resume. I apologize for those interruptions, and I think we're okay for a little while.

The—I will begin my questions, and that way we will try and expedite this. I think part of the—we want to make certain we have plenty of time for the second panel to fully evaluate what has not happened by way of regulatory response to this issue.

In beginning my own questions, I would submit for the record three articles that appeared in the Wall Street Journal: the first one dated April 28, 2007, detailing the business of debt collection in these accounts; another article, April 28, 2007, regarding bank use of set-off against Social Security accounts; and an article from February 12, 2008, involving the linkage between these accounts and the payday lenders, as has been described in testimony.

Is there objection to having these in the record?

[No response.]

Mr. POMEROY. Without objection, so ordered.

[The articles are not provided.]

Mr. POMEROY. What I am trying to understand is basically the dimensions of this as a rising problem, and broad concurrence that it's a problem, it's inappropriate, and that something ought to be done.

So, in that regard, start with Ms. Saunders, who has done extensive work, written extensively, on this topic. The Wall Street Journal article describes practices of, basically, in this automated age, debt collectors buying large volumes of uncollected debt, and just routinely, fairly electronically, sending out garnishments to the extent that individuals and banks can be identified, and that this has substantially expanded the reach of this kind of attachment process on bank accounts, including exempt funds. Would you care to elaborate?

Ms. SAUNDERS. Yes. Mr. Pomeroy, the problem—the reason this has suddenly become such a big problem is because the amount of bad debt that is being collected has exploded in the last few years.

First of all, credit card companies largely have been making credit to people—making credit available to many people who cannot afford to repay it, with the expectation that, despite the fact that they can't afford to repay it, they will try for many, many months or years. Much of this credit is made available to Social Security recipients, whose sole income is exempt from the reach of creditors.

When the credit becomes unpayable, and the bank itself writes it off, it generally sells the debts, these debts, to debt buyers for pennies on the dollar. So, if the debt is for $500, they might sell the debt to a particular debt buyer for $25 or $50. The debt buyer figures anything that it gets from the consumer, the recipient, is then gravy.

Once the consumer pays even $10 on that debt, it reignites the validity of the debt, for purposes of the statute of limitations, and the debt buyers are quite vigilant in trying to get any money out of these borrowers, out of these consumers.

That is, we think, the main reason—or one of the main reasons—that this problem has exploded. We have seen—I have never seen anything like it, the number of complaints coming from legal services office to the National Consumer Law Center, "What do we do with this problem?" "How can we help?" It's just exploded, as I explained.

Mr. POMEROY. Mr. O'Carroll, is there any question as to the status of Social Security funds as an exempt asset of the asset holder?

Mr. O'CARROLL. No, Mr. Pomeroy. They are exempt. There is no misunderstanding about it.

What we have found kind of interesting is, with the different types of banks, when we're taking a look at SSA funds going into accounts, we're finding the smaller, local type of bank usually knows who its customers are, its client base, and they very rarely are touching Social Security funds. They're being left untouched.

We are finding also it is kind of unusual that the bigger banks, which have a very good financing and auditing track record, are able to identify the Social Security funds, and in many cases, aren't touching them. What we're seeing now is the explosion of mid-sized banks, which are, in many cases, acquiring other banks' new accounting systems, they're not able to identify them, and they're the ones that are attaching these Social Security accounts.

Mr. POMEROY. Is there an electronic way these banks can fairly easily identify exempt from non-exempt assets in a co-mingled account?

Mr. O'CARROLL. We are finding with the Social Security ones, which are the only ones I can speak to, yes. I have heard in other cases, with other types of government accounts, that they have trouble identifying. In the Social Security one, we're being told that they can identify it.

Mr. POMEROY. So, upon receipt of a garnishment order, they would basically be able, through just entirely electronic means, to know which funds were basically exempt from that garnishment order and which funds weren't?

Mr. O'CARROLL. Well, to tell you the truth on that one, we have been asked by Senate Finance to take a look at garnishment, and we're in the process of doing that right now. So, rather than go on record on which ones they are and which they aren't, I will probably have to defer that for about another week, until that report comes out.

Mr. POMEROY. As to the question of the status of this exemption, is there a dispute among the relevant agencies, to your knowledge, as to the status of this—these assets, as exempt?

Mr. O'CARROLL. I will tell you I will have to answer that. I will double-check on that one, because as it stands now, I think we have been only looking in terms of the SSA benefits, and we haven't been talking to any of the other agencies to determine what their issues are. If we have, I will let you know.

Mr. POMEROY. All right. Are these relationships with check—where a deposit is made in a bank, and the only access to those funds are through a check-cashing, a related check-cashing entity, is that legal?

Mr. O'CARROLL. It gets into a gray area, Congressman. What we're finding is that in most cases, the beneficiary is allowing that check casher to be a co-sponsor on the account. So, the beneficiary is giving the check casher permission to do it. So, in those cases, it's not illegal. Giving another person the availability of sharing your account with you isn't illegal. It's sort of a gray area.

Mr. POMEROY. A gray area, although the marketplace practice, you note, is 96 percent of the individuals, the Social Security recipients doing this, have some kind of disability, and more than half of them have a mental impairment?

Mr. O'CARROLL. Yes, Mr. Pomeroy, that is one of the problems with the client base of SSI, is that it's going to be very high, in terms of mental disorders and issues like that. So, you're right, you're wondering——

Mr. POMEROY. Is it your conclusion then, that it's questionable legality, but there is no question about the marketplace focus, and that is on the most vulnerable impaired recipients of Social Security dollars, because in a straight-up proposition, people would not choose to enter such a very costly arrangement for getting their Social Security check cashed?

Mr. O'CARROLL. Yes, Mr. Pomeroy. That is the case. In most of these cases, it is sort of a check casher of last resort.

Mr. POMEROY. Finally, an issue that I worked on with Mr. Salisbury for some time, financial literacy, it is pathetic that, in the days of expanded credit and defined contribution retirement savings plans, which heap the responsibility on the individual, and all of the other complexities of 21st century finance, that what we offer in schools on a universal basis is a pale remnant of what was offered in the 1970s.

I mean, this is a case where we have taken dramatic steps backward in the face of much greater need for it than ever before. We better get with that. It is——

Mr. SALISBURY. I think that is very true, and other Committees of Congress are dealing with that. It should be a very, very high priority.

One thing in the Social Security area that is specific to this issue would be just to underline the critical nature of the Social Security benefit statement that goes to every individual over the age of 25 shortly before their birthday. That type of a communication can also be used very effectively to educate individuals to concerns they should be aware of, relative to Social Security. It does not, obviously, deal with the high rate of mental disability of many of the people that get it. The education need is huge.

Mr. POMEROY. Thank you. With Committee members here, I won't take any more time with my own line of inquiry. Mr. Brady?

Mr. BRADY. Thank you, Mr. Chairman. Like you, I want to thank the panelists. Every one of you brought a unique perspective to today's hearing, and I really appreciate it.

Mr. O'Carroll, for the hearing record, your report says in most cases it appeared the Social Security Administration did not know SSI payments were being sent directly to non-bank financial service providers. Is that the case?

Mr. O'CARROLL. Yes, Mr. Brady. All they're really going on is a routing number. So, they don't know who the account is titled to.

Mr. BRADY. Okay. A number of the practices you refer to in your report are already prohibited by Federal and state law. Will you refer violations of these laws to the proper enforcement agency?

Mr. O'CARROLL. Well, Mr. Brady, from our study in this case what we're finding is the only thing that is really illegal is when you start to re-enroll somebody.

So, in other words, let's say somebody enters into an agreement with you, you go into the joint account, and then that individual realizes that the account is being charged, or whatever, has a complaint, and then contacts Treasury and lets Treasury or SSA know that they want their account changed to a different account holder.

Then, if the loan agency, then changes that back, that would be illegal. That was mentioned in the Wall Street Journal article. We've got to tell you that's very rare. In fact, in that one instance, as soon as SSA found out about it, they changed it back to the beneficiary's address.

So, I've got to tell you, if it does become illegal, yes, we will, act on it, and refer it, but there is a lot of a gray area here, up to and including the types of interest that are charged for short periods of time, and everything else.

Mr. BRADY. So, it—in those cases that you described, once they are aware of it, and they continue the practice, in effect, it's illegal.

Mr. O'CARROLL. Yes.

Mr. BRADY. The basic question, are our current state and Federal laws sufficient to protect beneficiaries against these practices, your answer would be? Sounds like no.

Mr. O'CARROLL. I agree. At this point now, we are able to, enforce the re-enrolling of an account, and then there are other types of violations.

Because we are finding when the individuals themselves are authorizing the other person to be a payee with them, that's not illegal.

Mr. BRADY. Okay. So, at this point it's not an enforcement issue. Is that correct?

Mr. O'CARROLL. Correct.

Mr. BRADY. It is we do not have the protections in place in law, state or Federal, to protect these seniors.

Mr. O'CARROLL. Yes.

Mr. BRADY. Great. Thank you. I yield back, Mr. Pomeroy.

Mr. POMEROY. Mr. Levin.

Mr. LEVIN. Thank you, and welcome. Let me try, if I might, to help get to the heart of this. Clearly, there are some entities that abuse, and others that don't.

Number one, is there any doubt that there is Federal jurisdiction over, for example, garnishment practices? They are now, basically, in most cases under state law. Is there any doubt that we have the power regarding these payments to regulate the garnishment? Is there any doubt, legally, Constitutionally?

Ms. SAUNDERS. Mr. Levin, in my mind, there is no doubt. There is apparently considerable doubt among the agencies. So, that is probably a question you need to ask them.

State law does unequivocally govern the method of attaching a debtor's goods and money, and it also covers how that money should be released, but——

Mr. LEVIN. I understand that. These are Federal funds.

Ms. SAUNDERS. In our opinion, as I have articulated in our testimony, we think there is no doubt that, when there is a dispute between Federal law and state law, the Federal law trumps. It would be an inappropriate interpretation of state law to say that because state law does not specify a mechanism to ensure that Federal benefits which are exempt are protected, that that state law then makes those benefits unexempt.

So, it's clear in the minds of the legal scholars at the National Consumer Law Center, and a lot of law professors as well, that the Federal law does clearly trump any inconsistent state law.

The question is, how do we enforce that? We have proposed a number of different ways, and I hope in the next panel you will hear that some of those means might be accomplished in the near future.

Mr. LEVIN. Quickly——

Ms. SAUNDERS. May I——

Mr. LEVIN. Yes, go ahead.

Ms. SAUNDERS. Mr. Brady asked the question of whether or not the current master/sub-account arrangements were illegal, and I would like to address that, if that's all right.

Mr. LEVIN. Go ahead.

Ms. SAUNDERS. When EFT–99 was passed in 1996, Congress very specifically required Treasury to issue regulations to protect recipients of Federal benefits who were—had to obtain bank accounts to receive benefits electronically.

Treasury was well aware 10 years ago of the potential for these problems. In fact, it issued an advanced notice of public rule-making, asking the question exactly about which you all are puzzled today, which is, “Should Treasury issue a regulation prohibiting relationships between banks and non-bank financial services providers?”

Jean Ann Fox and I worked very, very hard to convince Treasury that the answer is an unequivocal yes, and we filed extensive comments, again, on behalf of dozens of state and local legal services providers, showing exactly what language Treasury could implement in their regulations that would have prohibited—and still would prohibit—these kinds of problems.

They could still do that today, and that would be the end of the problem for Social Security and Veterans, and other Federal benefits.

Mr. LEVIN. That relates, really, to the second question I was going to ask. I don’t see how anybody can claim that we don’t have jurisdiction relating to garnishments, when they’re Federal-sourced funds. I don’t understand the argument.

Quickly, in the time I have left—and it relates to what you said, Ms. Saunders—quickly tell us what you think should be done in addition to the garnishment issue. What should the Federal Government be doing now? Just quickly.

I mean, literacy education well and good, but Mr. Salisbury, I don’t think you’re here to say the basic answer is to blame the consumer, right? You’re not saying that. Okay. So, I will start with you, Mr. Salisbury. What should be done?

Mr. SALISBURY. In this particular case, I think clarity should be provided, vis-a-vis the types of regulations that were just mentioned, where the congress—the government has the ability to stop the practice, as a first item.

I think the second thing for the congress to consider is with major efforts now underway to extend required bank accounts and electronic funds transferred to the 40 million unbanked, that many of the issues you’re facing here on this topic are going to extend to a much broader segment of the population, as the equivalent of EFT–99 becomes generalized.

Mr. LEVIN. Ms. Fox? Quickly. The red light is on.

Ms. FOX. Mr. Levin, we think there are several solutions that you all could back. One is to urge the Social Security Administration to follow through on the docket in which they asked for comments recently to stop the use of master/sub-accounts to funnel exempt funds through a daisy chain of banks and financial service providers, stripping out Federal money as it goes, before it gets to the recipient. We think that could be stopped.

Treasury could go back and finish the job under EFT–99, and stop the use of financial intermediaries to provide access to banks.

Congress could enact H.R. 2871, the Payday Loan Reform Act that Representatives Gutierrez and Udall have introduced. That would stop lending secured by post-dated checks, or required electronic access to the bank account. Those are the protections that Congress has already given to active duty military and their families. They put payday loans off limits for that group of customers. You could do the same thing for exempt Federal recipients.

Also, we can promote Treasury’s new direct debit card, which is a pretty good product. It’s being offered to unbanked Social Security recipients. It will be rolled out across the country by the end of the summer. You can use that card for free. You're protected by Federal Deposit Insurance coverage, you're protected by the Electronic Fund Transfer Act. You can't overdraw it. You can't use it as a credit instrument. That will help bring in folks who don't have access to a regular bank account to have the safety of direct deposit without all of the risks that go with these extra products.

Mr. LEVIN. My time is up. Maybe somebody else will let—you have already, Ms. Saunders, given a partial answer. I am not sure, Mr. O'Carroll, that you would want to at this point. Ms. Smith, maybe someone else will give you a chance to answer that. Thank you.

Mr. POMEROY. Thank you. Mr. Lewis of Kentucky.

Mr. LEWIS. Thank you, Mr. Chairman. Mr. O'Carroll, the financial institutions, the banks, the—and the others who receive these Social Security payments, they're all aware that they cannot freeze the Social Security bank account. Aren't they aware of that, that it's exempt, it's illegal for them to do that?

Mr. O'CARROLL. Yes, Mr. Lewis. They are aware of it. Again, as I said, we are still in the midst of doing our work taking a look at the largest banks and what their policies and procedures are on garnishment. We're going to have that report out by the end of the week.

Yes, we are finding that they are aware of it. Where you run into different issues is the intermingling of funds. That is where, probably, the biggest thing with the banks is if there are other funds in an account, other than, as an example, the SSA check.

Mr. LEWIS. If there is some confusion, cannot the Social Security Administration make it pretty clear to these financial institutions that they cannot use a Social Security recipient's funds for garnishment payments, period? If they do, that's an illegal act? It's an illegal act against the Federal Government?

So, it seems to me like a few enforcements to these particular institutions that would break this Federal law of exemption would probably set a good example for the rest of them not to go down that road. Is that not fair?

Mr. O'CARROLL. Yes. Well, our feeling on it is yes, Social Security should be doing more, in terms of educating the financial institutions, letting them know more about it. Public information on it, all of that is very good.

The other one, which was discussed earlier, is that they should be working with Treasury Department, and having Treasury Department informing the institutions also on it, to remind——

Mr. LEWIS. Right.

Mr. O'CARROLL.—them of this issue. You have to remember, the law that we're talking about, the assignment and garnishment, is a 1935 law.

Mr. LEWIS. Yes.

Mr. O'CARROLL. Technology sure has changed a lot in the last 70 years.

Mr. LEWIS. Sure.

Mr. O'CARROLL. So, I think something to clarify that would help, too.

Mr. LEWIS. Well, and I think it's not—you know, I don't think we need more legislation. I think what we need from the Agency is to make it perfectly clear to these financial institutions what their requirements are. If they don't live up to those requirements, then the enforcement should come along and—again, I think a few put on the spot and reprimanded and whatever, fined or whatever to make an example of them, would probably start to make the others think about what they're doing.

Mr. O'CARROLL. Yes, Sir.

Mr. LEWIS. Thank you.

Mr. POMEROY. Ms. Tubbs-Jones.

Ms. TUBBS-JONES. Thank you, Mr. Chairman. Good morning. I want to jump all over the place, only because I only have five or seven minutes.

First of all, I am a firm believer that financial literacy is an important thing for all of us. The reason I think about it is I am looking at USA Today, and yesterday it says how a cup of coffee can set you back an extra $34. I have copies of this for the Members of the Committee, if you want to pass them down for me.

[The article is not provided]

An ATM card you have, and the bank allows you to make a $3 purchase of a cup of coffee, and if you don't have the money, they charge you $34 on the piece. So it's not—it's at every level that we have to figure out what we're going to do to protect not only those who aren't traditionally in a banking relationship, but all of us who are in a banking relationship.

The process—I should say for the record, since I am a former judge, there was another editorial on the same page that said fees are a deterrent, but that's not my piece this morning, so I'm going to leave that one. You're welcome to go read that one if you choose.

I have a question—I lost my place—for you, Mr. O'Carroll. I am not a proponent of predatory lending, but I recognize that in many inner city communities, the fee cashing services in those communities were the only place that folks who live there have to go, because financial institutions, in fact, deserted many of the inner city communities across the board.

In your report you seem to lump into one category check cashing facilities and payday lending facilities. Also in your report, I note that in a footnote you say that, "The SSA IG did not confirm whether payday loans were among the financial services offered by the non-bank FSPs." Are they or aren't they?

Mr. O'CARROLL. We didn't interview the actual beneficiaries, which is what that footnote is reflecting. We didn't ask them, "Did you sign up with this institution for a payday loan?"

However, what we did do is we identified two of these financial service providers, went to them and interviewed them, and found out from them that, yes, they do payday loans, and yes, that in many cases it is the beneficiaries that they are taking the loans from.

In another case on sort of the global——

Ms. TUBBS-JONES. The beneficiaries that they're taking their loans from, or——

Mr. O'CARROLL. No, this is the loan company.

Ms. TUBBS-JONES.—that they're lending to?

Mr. O'CARROLL. The lenders are saying that they do payday loans——

Ms. TUBBS-JONES. Okay.

Mr. O'CARROLL.—to SSI recipients.

Ms. TUBBS-JONES. There is—I mean—go ahead, let me let you answer.

Mr. O'CARROLL. Okay. Then the other part of it, on the global part, when we started looking at banks, we did a survey of five banks on this. One of the banks said that the vast majority of their clients, or the vast majority of one of their clients were for loans. So, that's why we also were of the belief that payday loans are a major factor in this.

Ms. TUBBS-JONES. Okay. Again, having been a judge, I wish we had had an opportunity to bring the institutions, and sit them before us, and let them plead their case, one way or the other, whether they're doing or not engaging in this process.

But I did get a note from some of the folks I know in the payday lending institution that says that they do not use master/sub-account arrangements to receive Social Security benefits as security for a loan in conducting their payday lending business. In fact, they say that state law prohibits this practice, and restricts the acceptable collateral for a payday advance to a personal check.

It also says the state laws also require repayment of a loan by cash, personal check, or ACH authorization, not by a third-party check.

We are struggling out here, trying to protect our Social Security beneficiaries, and protect all of us. When somebody is liable for some conduct, we ought to point it to them. When they're not, we should not throw everything up against the wall and let mud splash on the institution.

But I have done that, and—Ms. Fox seems to want to say something, so come on, girlfriend, tell me what you want to say.

Ms. FOX. I shed a little light on the mix of products here. The master-sub-account arrangements are offered through financial outlets that also do payday lending, they do check cashing, they sell money orders, they do all kinds of financial services.

Recipients who are getting their Social Security check delivered through a master/sub-account are most likely unbanked. That means they are not eligible to get a payday loan. The banks and the intermediaries that are delivering Social Security SSI checks that way have credit products of their own that function like a payday loan. It's a cash advance, it's a high fee that you——

Ms. TUBBS-JONES. I understand. So, it's not solely payday lenders who have these type of predatory agreements, if we want to call them that, it's financial institutions as well that also have it.

Ms. FOX. Right.

Ms. TUBBS-JONES. That's what I'm talking about. It seems like, today we want to—I have a 24-year-old son that sometimes I want to use his terminology, because it works so much better. Today we're dissing one group, next week we'll be dissing another group, trying to throw them all together and not trying to reach the final accomplishment that we want.

The basis of all of what I am saying to you is my goal is not to be a spokesperson for payday lenders, financial institutions, but be a spokesperson for the Social Security recipients, and the people who don't have a voice.

Ms. FOX. Yes.

Ms. TUBBS-JONES. So, to all of you, come up with something and recommend to us some policy that will allow us to do that, and won't have a place where people can kind of glide and slide by their responsibility.

I don't have any time to yield back, but I'm done, Mr. Chairman.

Mr. POMEROY. Thank you, and I am very pleased Mr. Johnson, fresh from the airport, is with us. Sam, please proceed.

Mr. JOHNSON. Yes, I didn't see anybody making loans out there. They didn't give me one.

Mr. Salisbury, we know one of the important ways we can protect seniors is through education. You noted in your testimony financial literacy of the population is pretty low.

What specific recommendations would you offer to the Social Security Administration, or other regulatory bodies and private enterprises, such as AARP, regarding efforts to provide greater education to bring about a higher level of financial literacy in the country?

Mr. SALISBURY. Well, one, as I noted in my testimony, there are some current multi-party experiments underway, funded by the FINRA Investor Education Foundation that include AARP, the State of Washington's education authority, and others, that are going into senior's facilities and testing extensive education.

I think the second, vis-a-vis the Social Security Administration per se, they are doing a lot, and have done a lot in the last few months. They are doing a complete rework of their website which will be issued soon that will make it far more user friendly for beneficiaries, and they are coming out with a number of new tools and calculators that allow individuals to make better decisions about timing of Social Security. So, I think they are taking steps.

I mentioned the Social Security statement, which goes to active workers. That could be used even more effectively—more changes have been made in it—but as an educational tool for individuals.

Finally, I would note that what is striking about this particular issue in the testimony of the inspector general is that this particular vulnerable population is 98 percent supplemental security income, and half of them with mental disability issues. Quite clearly, that is a population where financial literacy education cannot solve the problem, and it underlines why it's so important for the Committee to be dealing with this.

But I think, as an overall issue, there is much Social Security is doing, more they can do, and much that is being tested in the private sector with coalition efforts like that undertaken and mentioned in my testimony.

Mr. JOHNSON. Thank you. You know, for all of you, rather than relying on Federal regulators to agree on how Section 207 of the Social Security Act should be implemented, do any of you think that Congress needs to pass amendments to help the agencies, the various agencies, help the people?

Or is it okay out there if people just adhere to common sense, really? Anybody. Ms. Saunders?

Ms. SAUNDERS. I think—we think the law is clear, that it's up to the agencies to implement it.

Mr. JOHNSON. Which agency?

Ms. SAUNDERS. The Treasury, the Federal banking regulators, and the Social Security Administration, and the other payment——

Mr. JOHNSON. We keep adding stuff to Social Security, and they don't have the finances nor the people to keep adding things on. I just told him that, and you know, we see it every day. I know Mr. O'Carroll does, too.

But, perhaps you're right about the banking industry. Maybe they've been a little lax.

Anybody else want to comment on that?

[No response.]

Mr. JOHNSON. Okay. You guys are backing off of the subject here. Can't believe it.

How about Mr. Salisbury, returning to the issue of financial education, is there any campaign or initiative that you know of that would help, or any existing model that you might recommend?

Mr. SALISBURY. Well, on the floor today I believe you will be taking action, or proposing action, on National Save for Retirement Week. Those types of efforts add broad-based public education, encouraging employees to undertake education——

Mr. JOHNSON. Yes, that National Save for Retirement, I'm a cosponsor of that.

Mr. SALISBURY [continuing]. Are important issues.

Mr. JOHNSON. People just don't want to save. You know, they get down to the end of the line and there is not enough money there.

Mr. SALISBURY. Well, I describe it in our Choose to Save program as the equivalent of water drip torture is, as the topic of this hearing underlines, and as some of the earlier testimony, is the ability for one to get credit cards and to have them flow into your mailbox, the opportunities to spend and borrow, we are inundated—and people are inundated—with those messages.

I think the key—and it's what your legislation on the floor today would help do—what we try to do with our Choose to Save program, other government programs, and private initiatives is the effort to counter-balance some of that messaging, and as I noted in my testimony, efforts to essentially get individuals to be very, very critical consumers, to more readily ask questions.

One which was found in the most recent FINRA work is simply encouraging individuals, when they are getting advice from somebody unsolicited, to check out whether or not that person is properly registered, et cetera. There is much individuals can do. There is much that the society needs to do.

Mr. JOHNSON. Thank you, Sir. Thank you, Mr. Chairman.

Mr. POMEROY. Thank you, Mr. Johnson. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Let me pick up just on some of the observations that I have heard today from other Members of the Committee.

I agree with Mr. Levin, that I don't think there is much of a basis for an argument about the scope of Federal jurisdiction in this area. I would argue that the congress has already asserted its jurisdiction by declaring Social Security or SSI funds exempt from collection proceedings. That has already happened, and I think it's a fairly well established proposition that if Congress has a power, it has the lesser ability to enforce that power. That's the case in all manners of—areas of the law.

That leads me to a second question. Following up on Ms. Tubbs-Jones's observations, I don't know if the issue so much is seniors depositing their Social Security accounts into payday lending institutes or check cashing institutes, per se. I think the issue is the fees they tend to charge.

So, question for the panel, if Congress has the authority to declare off limits the collection of these accounts, and if Congress has the lesser power to enforce that, the regulations by the Social Security Administration, does Congress not have the power to say, in effect, that we will permit Social Security checks to be deposited into these institutions, but we will have a particular fee schedule that we approve, and anybody outside that schedule, we won't allow it to be deposited into those accounts?

Ms. FOX. When EFT–99 was enacted, Treasury was told to adopt regulations that would provide equivalent consumer protections and access to accounts, so that folks who had been unbanked, and who were becoming banked in order to get direct deposit, would be protected.

These master/sub-account arrangements do not provide consumer control over the bank account. I don't think that just limiting the fees would provide a first class bank account for a Federal benefit recipient.

Mr. DAVIS. Well, let me ask you, Mr. O'Carroll, do you dispute that the Social Security Administration would have the authority to, in effect, set up a scale and say that for these Federal-sourced monies—SSI, Social Security benefits, because they're Federally-sourced monies—we're going to set a schedule, and any fees outside of that, we won't permit it to be deposited into that account? Is that an authority that you all have, in your opinion?

Mr. O'CARROLL. Mr. Davis, I would say yes, that they could give that type of guidance or some guidelines on it.

The one thing we haven't talked about here, which is, I think, a possible solution, and it goes along to what you were saying there, is that the Treasury debit card is now coming out. The debit card has set fees on it, in terms of that. You get one withdrawal for free. There is a set fee on how much it's going to be each time you take it out. You can use it for purchases, you can use it to get cash back.

I think, in a lot of ways, it's a solution to what your colleague was saying in terms of the last resort type of check cashers. I think this new debit card, when it comes out, we're proponents of it, and I think that would be a solution to a lot of these issues.

Mr. DAVIS. Let me move on to another area, given the time constraints we have. I'm not sure at all that I understand the arguments about why the Commingling of funds is somehow an obstacle to the banks carrying out the law regarding the exemption of Social Security benefits. I mean, it's not complicated. I mean, any bank I know of can tell you where the money in the account comes from.

So, therefore, it's pretty simple. All you have to do is evaluate what funds came from Social Security accounts, look at the amount of the garnishment, or the judgment, deduct from it the value of the Social Security funds, and what's left over you can seize. If it leaves nothing, it leaves nothing. I don't understand why there would be any obstacle to that. I can tell that I think Ms. Fox and Ms. Saunders agree with that.

The final observation that I would make is that I suspect that most people do not appreciate that the collection process in virtually every state in this country only has a minimum level of adversarial nature to it.

As a practical matter, any lawyers of a practice in small claims court can tell you the overwhelming majority of cases consists of one side showing up and the other side doesn't show up. You issue an order, the bank enforces it, the bank tells you they've enforced it. Then you have an opportunity to go in to contest it. You know, whether we can possibly devise a better system or not, I don't know.

But, as a practical matter, it wouldn't matter how much information the consumer had. You could have 100 percent education of seniors about their Social Security proceeds being protected from garnishments, but it wouldn't matter, because, as a practical matter, all they can do is go in after the fact, and contest a judgment or a garnishment.

So, given that the collection process in this country is tilted so overwhelmingly in favor of the creditor, or the debtor, as opposed to the creditor, the person loaning the money, instead of vice versa, it would seem to me that this has to rest on the banks, and it has to rest on the Social Security Administration, in effect, penalizing banks who allow funds to be removed.

I mean, a bank, ultimately, is the keeper of your assets. Most banks advertise that they do a better job than anybody in the world of protecting your assets. So, if they're going to do that, by definition certainly they have to enforce the laws that exist.

Mr. POMEROY. Would the panel respond to the proposition? Do you think the banks could and should do that? There is a consensus across the panel

Let me ask you, when the banks are allowing complete attachment and garnishment on these commingled funds, is it almost inevitable that a string of fees will attach to the bank from the Commingling? Does the bank have a compelling financial interest in not breaking out the exempt funds?

I mean, in other words, have banks found a handsome little profit in doing business in ways that basically do not protect the funds, the Social Security funds, of their depositors?

Ms. SAUNDERS. Well, in our opinion, the answer must be yes, because advocates on a state level have tried to resolve these problems in state after state. Rather than the response from the banks being, "How can we deal with this so that exempt funds are, in fact, protected," the response routinely in many states has been, "No, we don't want to have to look. We don't want to have—it's not our job to protect exempt funds."

In fact, in one state, in Virginia, the advocates, the local legal aid attorneys, were successful in changing the law, and the banks went and got the law changed back. So, our only assumption can be from that that the banks have a financial interest in retaining the current system, where exempt funds are frozen, and fees are taken from those exempt funds.

I have, in the appendices to my testimony, several examples where hundreds and hundreds of dollars were taken from exempt funds, as a result of fees for overdraft, for garnishment, for the administration, for the determination that the bank account was exempt. All of these types of activities are accompanied by fees from the banks, and charged as against exempt funds.

In fact, one point that I didn't illustrate in the testimony is that banks claim in most situations that if there is a state law limit on how much funds—how much of these—how much these fees can be, that those state laws are pre-empted, and that the banks can charge—so long as they're a national bank or a Federal thrift, they can charge whatever they want.

Mr. POMEROY. All right. Any other comments for this panel? We will move to the—yes, Ms. Stephanie Tubbs-Jones.

Ms. TUBBS-JONES. I just would seek unanimous consent to have another article placed in the record. This is a Washington Post article of Monday, June 23rd, called, "The Color of Credit," where it talks about the impact that race has, also, or the fact that racism occurs within the credit community. I would just like to have it submitted for the record.

Mr. POMEROY. Without objection, so ordered.

Ms. TUBBS-JONES. Thanks.

[The information follows:]

The Color Of Credit

BY CHARLES STEELE JR.

MONDAY, JUNE 23, 2008

The subprime mortgage fiasco is sending tremors through Wall Street and has brought the U.S. economy near (if not into) recession. For African Americans and Latinos—the primary victims of the debacle—the mortgage meltdown may widen the considerable gap in wealth that already exists between whites and people of color. Even worse, some proposals to fix the problem of limited access to credit may end up doing more harm than good.

"We estimate the total loss of wealth for people of color to be between $164 billion and $213 billion for subprime loans taken during the past eight years. We believe this represents the greatest loss of wealth for people of color in modern U.S. history," the Boston-based organization United for a Fair Economy noted in its report "Foreclosed: State of the Dream 2008."

To understand how the damage goes far beyond these mortgages, one has to understand the importance of owning a home. It is the cornerstone of the American dream. For many, it is also the first step to creating wealth. As with numerous aspects of American society, there is a wealth gap in this country: According to the Census Bureau, the median net worth of a household headed by a white adult in 2004, the latest year for which data are available, was $118,300, compared with just $11,800 for black-headed households.

The bureau also reported that three-fourths of white households owned their homes in 2004, while less than half of black households owned theirs. A variety of factors, some economic and some based on racial discrimination, account for that ownership gap.

As a result of laws enacted to address housing discrimination, the rate of African American homeownership rose from 42.3 percent in 1994 to 49.1 percent in 2004, the highest level in U.S. history. As great an achievement as that is, a 49.1 percent rate is about where white U.S. ownership stood in 1900.

Led by former housing and urban development secretary Alphonso Jackson, the Bush administration made expanding homeownership a top priority. In fact, some critics say the administration did so while ignoring signs of an impending crisis in the subprime mortgage market.

Even at the rate African Americans were progressing before the crisis, noted the United for a Fair Economy report, it would have taken 594 years for black median household net worth to equal that of whites. Sadly, the declines in the housing market have only made things worse.

Yet some of the proposed reforms relating to credit may ultimately be counterproductive. For example, the Federal Reserve is accepting public comment until Aug. 4 on a rule that would prohibit certain fees in connection with subprime credit card lending. While one might hope that capping fees for subprime credit products would result in better credit terms for borrowers, it is more likely that many issuers will cut back on offerings or simply exit the market.

That's what happened with guaranteed student loans after Congress engaged in price-fixing last year: The student lending market evaporated. Justifiably panic-stricken parents, students and education advocates forced Congress to hastily craft corrective legislation, which President Bush signed into law last month.

Consider also the Credit Cardholders' Bill of Rights Act (HR 5244), which would require that many consumers pay—upfront—all fees assessed during the first year of a new account, before the card is even issued. Because an ability to pay over time makes such cards affordable for many consumers, this provision would effectively deny credit to millions of those whose rights such reforms are meant to protect.

Our government should protect every consumer—regardless of race, religion or credit score—from fraud and fly-by-night lenders. Policymakers should also promote a consumer credit market that helps people whose credit scores are less than stellar to bridge their way back to prime.

Lack of access to credit for those with low credit scores, or no credit whatsoever, is an important and growing problem. Credit scores, traditionally used for mortgages and auto loans, are increasingly used in determining eligibility for employment, auto insurance, apartment rentals, utility connections, and opening and maintaining checking accounts.

Like homeownership, credit is a cornerstone of wealth creation. The FDIC recently stated that "it is very difficult to build wealth without access to credit." That's an extreme understatement. It is almost impossible to build wealth in America without credit.

Dr. Martin Luther King Jr. often said that the cause of economic justice is the cause of social justice. We must continue to work together to achieve that timeless goal in lending and, more broadly, in our nation's economic sector.

Charles Steele Jr. is president and chief executive of the Southern Christian Leadership Conference.

Mr. POMEROY. Thank you very much. Excellent panel. We move now to the second panel, the Federal agencies.

Good morning. We will remind the witnesses that your written statements will be accepted in full. We ask that you keep your presentation to 5 minutes. We remind the panel that the green light before you will turn yellow, and then red when the time is up.

Without further ado, let us start with Ms. LaCanfora, assistant deputy commissioner of retirement and disability policy, SSA.

STATEMENT OF MARIANNA LACANFORA, ASSISTANT DEPUTY COMMISSIONER OF RETIREMENT AND DISABILITY POLICY, SOCIAL SECURITY ADMINISTRATION

Ms. LACANFORA. Mr. Chairman and Members of the Subcommittee, on behalf of Commissioner Astrue I thank you for the opportunity to discuss protecting vulnerable Social Security beneficiaries from predatory lending and other harmful practices.

We recognize that Social Security often is an individual's sole source of income, and we are committed to ensuring that our beneficiaries have full use of their benefits. As a result, we are working closely with the Department of Treasury and support inter-agency action to strengthen protections for our beneficiaries.

Section 207 of the Social Security Act protects beneficiaries' payments from assignment, garnishment, and other legal process. This Subcommittee has raised two specific situations that implicate Section 207 predatory lending practices, and third-party garnishment of bank accounts.

I would like to discuss our concerns with predatory lending practices. Certain lenders circumvent our policies, causing harm to beneficiaries. Let me explain how this happens.

Treasury rules require that Federal payments issued by electronic funds transfer be deposited into a bank account only in the beneficiary's name. However, Treasury made an exception for individuals with investment accounts. In that situation, Federal payments may be deposited directly into a master investment account, and then credited to an individual's sub-account.

We extended this master/sub-account rule to provide those beneficiaries without traditional bank accounts convenient choices for receiving benefits, including direct deposit. When we extended the policy, we established strict conditions.

First, the master account must be at a regulated financial institution. Second, there must be a sub-account in the beneficiary's name, and the master account holder must maintain individual sub-account records showing all activity. Finally, the beneficiary must voluntarily agree to the arrangement, and be able to terminate it. These requirements are intended to protect beneficiaries and ensure that they, not their creditors, maintain control of their funds.

In a February 28, 2008 article, the Wall Street Journal described a situation in which a loan company repeatedly re-enrolled a Social Security beneficiary in a master/sub-account arrangement against the beneficiary's will. This egregious action is a clear violation of our policy. In fact, we stopped those unauthorized direct deposit re-enrollments before that article was published.

While there have been only isolated instances of these types of abuses reported to our employees, we intend to do everything we can to safeguard the rights of our beneficiaries. Shortly after the article was published, we notified the public that we are reconsidering our master/sub-account policy, and we asked for any comments by June 20th. We requested that public input to better understand the scope of this practice, so that our changes are fair and comprehensive. We will carefully consider all comments we have received.

As we re-evaluate our policy, we will coordinate with Treasury to ensure that any changes are consistent with their rules. We will also make sure that beneficiaries are not discouraged from using direct deposit, which is a safe and convenient way to receive payment.

Now, let me turn to garnishment. Garnishing Social Security benefits in a bank account conflicts with Section 207. We recognize the need to enforce this provision. Oversight of banks and other financial institutions rests with the banking regulators, and we are committed to supporting them in their efforts to enforce Section 207.

Despite Federal law, some State courts will issue orders garnishing funds in an account containing Social Security payments, and banks will often take action to comply. Commissioner Astrue asked OMB to establish a coordinated inter-agency effort to address these banking practices. Treasury has stepped forward to coordinate this inter-agency effort to clarify the rules concerning garnishment of bank accounts that include Federally-protected benefits.

Treasury is well suited to coordinate this effort by financial institution regulators and Federal benefit agencies to clarify garnishment rules because it is both the paying agent for the government, and the primary regulator of the Federal electronic payment system. We have discussed garnishment issues with Treasury staff, and we are working with them on a solution to this complex issue.

Mr. Chairman, we at Social Security share your concerns about protecting the financial well being of some of our nation's most vulnerable beneficiaries. We can only resolve these problems through a coordinated approach, and we will continue to work with Treasury and the bank regulators to protect beneficiaries.

Thank you for holding this important hearing, and I would be happy to answer any questions.

[The prepared statement of Ms. LaCanfora follows:]

Prepared Statement of Ms. LaCanfora, Assistant Deputy Commissioner of Retirement and Disability Policy, Social Security Administration

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to discuss our concerns about protecting our vulnerable Social Security beneficiaries from predatory lending and other harmful financial institution practices. We recognize that, in many instances, Social Security benefits are an individual's sole source of income and support, and we are committed to doing all in our power to ensure that our beneficiaries have full and appropriate use of their benefits. As a result, we are working closely with the Department of Treasury and support inter-agency action to strengthen the protections for our beneficiaries. Section 207 of the Social Security Act protects beneficiaries' rights to receive Social Security benefits directly and to use them as they see fit, by prohibiting third parties from attempting to seize the benefits through assignment, garnishment, and other legal process. Section 207 of the Act provides that the "right of any person to any future payment under this title shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law." The language of the statute is very clear; however, Section 207 does not provide us with any means for enforcement and does not establish any penalties for its violation. Unfortunately, abusive practices have occurred, to the detriment of our beneficiaries.

This Committee has raised two specific situations that implicate section 207—high-fee direct deposit arrangements with payday lenders and check-cashing businesses and garnishment of beneficiary accounts.

Payday Loans/Assignment

In 1998, Treasury published rules that required that any Federal payment made by electronic funds transfer be deposited only into a bank account in the beneficiary's name. There were two exceptions: one was for payments made to an authorized payment agent (e.g., a Social Security beneficiary's representative payee); and the second was for an investment account established through a registered securities broker or dealer.

Consistent with Treasury's rules, we began to accept master/sub-account arrangements so that beneficiaries' checks could be deposited directly into their investment accounts. We expanded the availability of master/sub-accounts as a convenience to our beneficiaries, most notably members of religious orders who relied upon these arrangements to honor their vows of poverty. By accepting these arrangements, we intended to provide our beneficiaries with choices that were appropriate and convenient for their situations. These arrangements permitted individuals who did not have traditional bank accounts or who chose alternative arrangements to take advantage of all of the benefits of direct deposit, while still retaining control of their funds.

To prevent these master/sub-account arrangements from becoming prohibited assignments of benefits, we established strict conditions for allowing Social Security payments to be deposited into a master account:

- The master account must be at a bank, savings and loan association, credit union, or thrift institution.
- The beneficiary must have a sub-account in his name, and the master account holder must maintain sub-account records for each participant. The sub-account records must show all money received and withdrawn and the balance remaining in each sub-account. This information must be available to the participant upon request.
- The beneficiary must voluntarily agree to this arrangement.
- The beneficiary must be able to terminate the arrangement.

These requirements on master/sub-accounts ensure that beneficiaries—not creditors—maintained control of their funds.

While we expected that this policy would provide sufficient protection for our beneficiaries, we have learned that some institutions have undermined this policy. In a February 28, 2008, article, *The Wall Street Journal* described a situation in which a loan company repeatedly enrolled a Social Security beneficiary in a master/sub-account arrangement against the beneficiary's will. While the beneficiary had agreed originally to have his checks electronically deposited into the lender's master account, the beneficiary sought to cancel that arrangement. Unknown to the beneficiary, the loan company resubmitted the information, directing that the beneficiary's check be deposited, once again, in the master account. This egregious action is obviously a clear violation of our policy.

When we learn about these violations, we cancel the direct deposit order. In fact, we resolved the issue cited by *The Wall Street Journal* article before the article was published. We also issued instructions for our employees to remind them of the procedures for handling such beneficiary complaints.

While we know of only isolated instances of these types of abuses reported to our personnel, we intend to do everything we can to safeguard the rights of our beneficiaries. Accordingly, on April 21, 2008, 2 months after *The Wall Street Journal* article was published, we requested public input on the master/sub-account policy in a notice published in the *Federal Register*.

Federal Register Notice

We have allowed master/sub-accounts for more than 10 years and are concerned that changes to our policy may have unintended consequences that could disrupt business practices that well serve our beneficiaries. We want to better understand the scope of this practice so that our changes will be comprehensive.

In the *Federal Register* notice, we asked for answers to questions such as:

- Have master/sub-account arrangements disadvantaged any of our beneficiaries and, if so, in what way?
- To what extent will the elimination of the master/sub-account arrangement in our procedures create significant costs and burdens on beneficiaries or organizations using this account arrangement?

Consideration of Changes in Policy on Master/Sub-Accounts

The comment period on the *Federal Register* notice closed only one business day ago. Although we need to change our policy, we must carefully consider all comments before we determine the nature or extent of the change. We want to ensure that we understand the possible effects on our beneficiaries.

We also want to make sure that any changes to our policy do not discourage beneficiaries from using direct deposit. We recognize that direct deposit provides beneficiaries with a safe and convenient method of receiving payment, and we fully support its use.

We believe expanded electronic payment service is an attractive option for payment. Treasury has recently introduced Direct Express, which makes banking services available at minimum cost to individuals who may not otherwise have access to traditional bank accounts. Through Direct Express, beneficiaries have their Social Security payments credited to a prepaid debit card, and they can access their funds without fees through services such as cash back with purchases and cash from bank tellers. The card also provides other services at low fees negotiated by Treasury. These electronic payment options can help beneficiaries avoid some of the predatory practices we are discussing today.

We recognize that there are problems with our current policy, and we are eager to make the necessary improvements. As we consider policy changes, we certainly will coordinate with Treasury to ensure that any changes are consistent with its regulations and that Treasury can enforce the provisions within the banking community.

Garnishment of Beneficiary Accounts

This Committee has also expressed its interest in examining how garnishment of Social Security benefits may conflict with benefit protections in the Social Security Act. As I noted before, Section 207 of the Social Security Act is clear that Social Security benefits may not be garnished by a creditor other than the United States government. We recognize the need to enforce this provision. Oversight of banks and other financial institutions rests with the banking regulators and we are committed to supporting them in their efforts to enforce Section 207. Despite Federal law, some State courts will issue orders garnishing funds in an account containing Social Security payments, and banks will take action to comply.

In order to address these issues, Commissioner Astrue asked OMB to establish a coordinated interagency effort to address these banking practices. He pointed out that the garnishment issue is complex, due in part to the interplay between Federal and State laws. Because a number of Federal agencies have responsibility in this area, we proposed this interagency approach.

Treasury has stepped forward to coordinate an interagency effort to clarify the rules concerning garnishment of bank accounts that include federally protected benefits. Treasury is well suited to coordinate an effort by financial institution regulators and federal benefit agencies to clarify garnishment rules because it is both the paying agent for the Government and the primary regulator of the Federal electronic payment system. We have discussed garnishment issues with Treasury staff and we are working with them on a solution to these complex issues. In developing a solution to protect Social Security beneficiaries, we would consider a joint regulation, if such an approach is determined necessary.

Conclusion

Mr. Chairman and Members of the Subcommittee, we at Social Security share your concerns about protecting the financial well being of some of our nation's most vulnerable beneficiaries. We can only resolve the problems under discussion at today's hearing, though, with a coordinated approach amongst agencies. As a result, we are working closely with the Department of Treasury and support inter-agency action to strengthen the protections for our beneficiaries." Thank you for the opportunity to express our concerns about these very important issues. I would be happy to answer any questions.

Mr. POMEROY. Thank you.

Mr. Grippo.

STATEMENT OF GARY GRIPPO, DEPUTY ASSISTANT SECRETARY FOR FISCAL OPERATIONS, U.S. DEPARTMENT OF THE TREASURY

Mr. GRIPPO. Mr. Chairman, Ranking Member Johnson, other Members of the Subcommittee, thank you for inviting me here today to discuss garnishment practices and their impact on Federal beneficiaries who receive their benefit payments electronically.

The Committee is to be commended for continuing to focus on this issue, and I am hopeful that we will be able to implement a solution that provides appropriate protections, as well as a balancing of consumer, government, and business interests.

Treasury is willing to offer expertise and to assist Federal benefit agencies in crafting a solution to this problem, leveraging our role in regulating Federal payments, and working closely with the banking industry.

Treasury strongly encourages and actively promotes electronic payments as the safest, cheapest, and most convenient way to deliver Federal benefits. We do recognize that electronic payments may cause problems in certain cases.

Specifically, individuals who have bank accounts and are subject to garnishment action may find direct deposit unattractive. Financial institutions may freeze accounts that receive Federal benefits as they perform due diligence, complying with a myriad of state garnishment laws and court orders.

An account may be temporarily frozen, even when the account contains Federal benefits that are exempt from garnishment. Thus, a Federal benefit recipient who receives direct deposit may not be able to access lifeline funds because they have been automatically routed into a frozen account.

Treasury believes that any solution to this problem, whether operational, regulatory, or statutory, would ensure that Federal benefit recipients have access to a certain amount of funds that cannot be frozen while a garnishment order is adjudicated by the courts, and while the final amounts of exempt and non-exempt funds are determined. The model used to establish the appropriate amount of funds excluded from an account freeze would need to be developed based on an analysis of benefit payment amounts, and the ability of financial institutions to implement it without complex accounting and research.

This type of solution seems essential to ensure that benefit recipients have access to their statutorily-protected funds while the details of a garnishment order are resolved.

Treasury is willing to coordinate a joint inter-agency effort in establishing a regulatory solution to the problem, based on our experience in managing Federal payments and working with the banking industry. Treasury, the Social Security Administration, and other Federal benefit agencies must work together to develop specific guidance to financial institutions on the actions they must take if there are benefits in an account subject to a garnishment order. We have discussed options with Social Security Administration staff, and we look forward to collaborating with them, and the other Federal benefit agencies.

As part of this inter-agency effort, Treasury is willing to assist the Federal benefit agencies by serving as a central point of contact on implementation, compliance, and general administration of a rule, and then working with the appropriate Federal banking regulators on enforcement.

We know that the impact of garnishment orders and account freezes on recipients of Federal benefits is a public policy issue that needs to be addressed, and we look forward to working with the benefit agencies, consumer groups, the banking regulators, and financial institutions, to come up with a solution. I am pleased to address any questions on the matter.

[The prepared statement of Mr. Grippo follows:]

Prepared Statement of Gary Grippo, Deputy Assistant Secretary for Fiscal Operations, U.S. Department of the Treasury

Washington—Chairman McNulty, Ranking Member Johnson, and other Members of the Subcommittee, thank you for inviting me here today to discuss garnishment practices and their impact on Federal Government beneficiaries who receive their benefit payments electronically. The Committee is to be commended for continuing to focus on this issue, and I am hopeful that we will be able to achieve a solution based on sound public policy that provides appropriate protections and a balancing of consumer, government and business interests.

Treasury is willing to offer expertise and assist the federal benefit agencies in crafting a solution to this problem, leveraging our role in regulating Federal payments and working closely with the banking industry. Today, I will provide background on our role as a disburser of federal payments, our use of technology in disbursing government benefits, and our perspective on potential solutions to the garnishment issue.

Treasury's Role as a Central Disburser

One of Treasury's core functions is to develop policy for and to operate the financial infrastructure of the Federal Government. Treasury's Financial Management Service (FMS) provides central payment services to federal program agencies. FMS disburses 85% of the Federal Government's payments, including income tax refunds, Social Security benefits, veterans benefits, and other federal payments to individuals and businesses.

FMS disburses payments based on certified payment files received from program agencies. In FY 2007, FMS disbursed 982 million payments, of which 78% were issued electronically. Focusing specifically on federal benefits payments, such as Social Security and veterans benefits, or those categories of payments generally exempted by law from garnishment, FMS disbursed almost 800 million payments, of which approximately 81% were issued electronically. The largest federal benefit programs are Social Security and Supplemental Security Income, together comprising 71% of the payment volume. While the other federal benefit programs—veterans benefits, railroad retirement, civil service retirement, and black lung disability programs—represent a much smaller payment volume, the issues their beneficiaries may face when attempting to access lifeline benefits are the same. In our role as a central disburser, we would strive to ensure that any potential solution would work for all federal programs with exempt funds that are protected by law from garnishment.

Strategic Vision: Electronic Treasury

Integrating and leveraging technology into our payment programs is a long-standing strategic vision for the Department of the Treasury. Treasury's strategic goal to effectively manage the government's finances includes strategies for expanding all-electronic transactions to ensure timely and accurate payments at the lowest possible costs. Electronic payments provide real and meaningful savings not only to the government and the taxpayer but also to the financial industry. For Treasury, it costs approximately 98 cents to issue a check versus 10 cents to issue an electronic payment. When this 88 cents per item savings is multiplied over the millions of federal payments issued annually, and as recipients convert from checks to electronic payments, the savings can become substantial.

On our path toward an all-electronic treasury, we have benefited from statutes, such as the Debt Collection Improvement Act of 1996 (DCIA), that generally require federal payment recipients to receive their payment electronically. As the regulation implementing the DCIA was proposed and finalized, an appropriate public policy on electronic payments was developed, with waivers and carve-outs to electronic requirements so as to not impose an undue hardship on the payment recipients. With the implementation of the DCIA, the rate at which federal benefit payments were made by electronic payment increased from 56% in FY 1996 to 75% in FY 2000. However, since obtaining a 4–5% annual growth rate in the late 1990s, we have leveled off to a 1–2% growth rate, with some years seeing less than a 1% increase.

Treasury has also benefited from the broader acceptance of electronic banking technology as we strive to increase the use of electronic payments. In assessing our future, we recognize a changing landscape, with rapidly increasing federal benefit payment volumes resulting from baby-boomer retirements. One of our strategies to manage future payment issuance costs is to actively market and promote electronic payments, specifically direct deposit of benefit payments.

Promoting Electronic Payments

Federal benefit recipients may opt to receive their payment by check or electronically. For those recipients choosing electronic payments, Treasury offers two programs: Direct Deposit and the recently launched Direct Express card.

Direct Deposit is a payment program for consumers who authorize the deposit of payments automatically into a checking or savings account via the Automated Clearing House (ACH) network. It is Treasury's preferred payment method and is the best way for Americans to receive their federal benefit payments. The advantages of direct deposit to the government, banking system, and recipients are well documented. It is safe, convenient, reliable, and eliminates the risk of lost or stolen checks.

Ideally, individuals would sign-up for direct deposit when they apply for their benefit payment. Treasury is working with the Social Security Administration in encouraging more individuals who have a bank account to opt for direct deposit when applying for their benefit.

Just this month, Treasury launched the Direct Express card. The Direct Express card is a prepaid debit card offered to Social Security and Supplemental Security Income check recipients who wish to receive their benefits electronically. While specifically designed as a product for unbanked federal beneficiaries, anyone receiving Social Security or Supplemental Security Income benefits can sign up for the card. Treasury has designated a financial agent to issue this nationally available card for the payment of federal benefits. The features of the card were formulated after a one-year pilot program and discussions with consumer groups and other stakeholders. Most of the card services are free. There is no cost to sign up for the card and there are no monthly fees. While there are fees for a limited number of optional transactions, it is possible to use the card for free, and while the Direct Express card is currently available to only Social Security and Supplemental Security Income benefit recipients, Treasury plans to add other federal benefit programs at a later date.

Assisting Federal Benefit Agencies in Resolving the Garnishment Issue

Treasury strongly encourages and actively promotes electronic payments, but we do recognize that electronic payments may cause problems in certain instances. Specifically, individuals who have bank accounts and are subject to garnishment actions may find direct deposit unattractive. Financial institutions may freeze accounts that receive federal benefits as they perform due diligence in complying with a myriad of state laws and court orders. An account may be temporarily frozen even when the account contains federal benefits which are exempt from garnishment. Thus, a federal benefit recipient who receives direct deposit may not be able to access lifeline funds because they have been automatically routed in to a frozen account. If the recipient had received their benefits by paper check, they could cash the check without depositing it into the frozen account and have full access to the funds.

Treasury believes that any solution to this problem, whether operational, regulatory, or if necessary statutory, would ensure that federal benefit recipients have access to a certain amount of funds that cannot be frozen while the garnishment order is adjudicated by the courts and financial institutions, and while the final amounts of exempt and non-exempt funds are determined. The model used to establish the appropriate amount of funds excluded from an account freeze would need to be developed based on an analysis of benefit payment amounts and the ability of financial institutions to implement it without complex accounting or research. This type of solution seems essential to ensure that benefit recipients have access to their statutorily protected funds while the details of a garnishment order are resolved.

As referenced above, one operational solution to the problem that we currently have in place is the Direct Express card. The card account contains primarily Social Security benefit payments, which, under federal law, are protected from garnishment by creditors other than the United States government. This means that creditors do not have the right to have these funds taken out of the account, none of which would be frozen pending resolution of a garnishment order.

Treasury is willing to coordinate a joint inter-agency effort in establishing a regulatory solution to the problem, based on our expertise in managing federal payments and working with the banking industry. Treasury, the Social Security Administration, and other federal benefit agencies are working together to provide specific guidance to financial institutions on actions they must take if there are benefits in an account subject to a garnishment order. We have discussed options with Social Security Administration staff and look forward to collaborating with them and other federal benefit agencies. Treasury can offer its expertise in the payments and banking systems to help craft a government-wide policy solution. As part of this inter-agency effort, Treasury is willing to assist the federal benefit agencies by serving as central point-of-contact on implementation, compliance, and general administration of a rule, and in working with the appropriate federal banking regulators on enforcement.

We envision that through this interagency effort, we would provide guidance to financial institutions on how to discern if there are exempt funds in an account and what amount of funds should not be frozen. For example, a regulation could provide a safe harbor to financial institutions that follow the guidance and allow recipients access to funds. Treasury is working closely with the Social Security Administration and other federal benefit agencies on a number of complex issues that would need to be addressed as we move toward a solution. These issues include commingling of funds, account fees, look-back periods, compliance costs, and enforcement. We believe further discussion with stakeholders and a public comment period are essential to fully address these issues.

Conclusion

The impact of garnishment orders on recipients of federal benefit payments is a public policy issue that needs to be addressed. Progress has been made over the last 18 months in evaluating the complexities of this issue. Garnishment practices are also an impediment for Treasury as we strive to further promote direct deposit and electronic payments. Treasury is willing to use its expertise with Federal payments and commercial banking practices to help develop and implement a solution. We look forward to working with the federal benefit agencies, consumer groups, banking regulators, financial institutions, and the Congress to come to a consensus solution.

This concludes my formal statement. I am pleased to address any questions you may have.

Mr. POMEROY. Thank you.

Mr. Fritts.

STATEMENT OF STEVEN D. FRITTS, ASSOCIATE DIRECTOR, RISK MANAGEMENT POLICY AND EXAMINATION SUPPORT BRANCH, DIVISION OF SUPERVISION AND CONSUMER PROTECTION, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. FRITTS. Thank you, Mr. Chairman, Ranking Member Johnson, and Members of the Subcommittee. I appreciate the opportunity to testify on behalf of the FDIC about issues affecting Federal benefit recipients' access to protected benefit payments.

First, I will discuss the FDIC's perspective on situations where Federal benefit recipients may lose access to their funds as a result of a garnishment order. Then I will discuss our assessment of relationships between FDIC-supervised institutions, and payment distribution firms: check cashers, pawn shops, and payday lenders.

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. In that process, a state garnishment order is served on a bank, requiring that funds in a customer's account be frozen while that process sorts out who is entitled to the money. In the meantime, beneficiaries may be unable to pay their monthly bills, and can be subject to bank fees for imposing the freeze, and penalties for overdrafts and return checks.

The FDIC recognizes the important issues raised by the interaction of state and Federal law with regard to garnishment, and has been working to develop solutions that address the legitimate interests of both benefit recipients and their financial institutions.

Of major importance is providing a solution that addresses the hardship faced by beneficiaries' whose accounts are frozen, pending resolution of a garnishment order. While the FDIC doesn't have the legal authority to resolve these issues by itself, we have attempted to engage interested parties in reaching a solution.

A potential solution could be similar to statutes currently in effect in California and Connecticut. These laws enable depository institutions to provide beneficiaries with access to a pre-determined amount of money sufficient to pay for basic necessities like food and rent, while the dispute is resolved. We suggest that adoption of this approach on a nationwide basis could bring clarity and simplicity to the legal processes. Such an approach would allow beneficiaries access to vital funds, be relatively easy for deposit institutions to comply with, and would leave the state judicial system undisturbed.

Social Security Administration, the VA, and Treasury Department could implement this approach by promulgating rules under their current statutory authority. Alternatively, Congress could amend Section 207 of the Social Security Act and similar statutes to achieve the same outcome. However, it appears that ample authority exists under current law to address the issues surrounding garnishment through rule-making.

With regard to payday lending, the FDIC has long been troubled by the impact on consumers of costly short-term credit, such as payday lending, and has taken steps to limit this activity by FDIC-supervised banks, and to encourage banks to offer alternative forms of small dollar credit.

Reports have described situations where unbanked individuals, including recipients of Federal benefits, have authorized parties like payday lenders to deposit their funds in a bank account that these firms exclusively control. Consumers who receive their Federal benefit payments through these processes may be subject to unnecessary fees that could be avoided through simpler payment methods, such as the direct deposit of their benefits into a personal account with the beneficiary's own bank.

The FDIC has been actively reviewing these questionable relationships and practices. At this time, it appears that a small number of financial institutions supervised by the FDIC, as well as other Federal and state banking regulators, are involved in these arrangements. The FDIC intends to use its supervisory and enforcement tools to ensure that consumer protection and other banking laws are strictly adhered to.

While we continue to look at FDIC-supervised institutions' role with respect to the benefit payment distribution mechanism, which is usually a depository relationship, we also support SSA's willingness to address these challenges from the benefits distribution perspective. The FDIC supports the SSA's recent notice of request for comments to address problems surrounding the master/sub-accounts for the payment of benefits.

Also, we believe that with the introduction of the Direct Express Treasury debit card program, participating beneficiaries can be provided a simple and user-friendly vehicle to use and control their benefit funds, thus preventing the redirection of benefits to potentially unscrupulous entities.

In conclusion, the FDIC is committed to finding solutions to these important issues, and looks forward to working with the SSA, the U.S. Treasury Department, and other agencies, to find solutions.

I would be happy to answer any questions that the Committee might have.

[The prepared statement of Mr. Fritts follows:]

Prepared Statement of Steve Fritts, Associate Director, Risk Management Policy and Examination Support Branch, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation

Chairman McNulty, Ranking Member Johnson, and Members of the Subcommittee, 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, including senior citizens, veterans and the disabled. The FDIC is aware that actions that limit access to these funds result in hardship and expense for 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 financial institutions receive a garnishment or attachment order against an individual, they customarily freeze that individual's deposit accounts, often not knowing that the accounts might hold the proceeds of benefit payments which generally are exempt by law from garnishment. While the funds eventually are released, often through protracted legal processes, the customer can suffer financially in the meantime.

In my testimony, I will discuss the current 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 of this issue. Finally, my testimony will discuss additional practices related to the distribution of federal benefit payments that we are closely examining because of their effect on beneficiaries.

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 typically 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 has 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 Security Income (SSI) benefits, Veterans Affairs (VA) benefits, civil service retirement benefits, military retirement annuities, and railroad retirement benefits.[1] 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.[2] In addition, state laws often provide for certain types of funds to be exempt from garnishment, such as private pension payments.

[1] Some Federal laws protecting benefit payments from garnishment orders include 42 U.S.C. 407(a); 42 U.S.C. 1383(d)(1); 38 U.S.C. 5301; 5 U.S.C. 8346(a); and 45 U.S.C. 231m(a).

[2] For example, Section 207 of the Social Security Act provides that, with certain exceptions, moneys paid or payable as Old-Age, Survivors, and Disability Insurance (OASDI) benefits, are not "subject to execution, levy, attachment, garnishment, or other legal process." 42 U.S.C. 407.

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 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.[3] 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 failing to treat 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, when the relevant funds were deposited electronically.[4]

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."[5] 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 Affairs staff have stated that they 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 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, under the framework set up by many state laws, 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 garnish-

[3] *McCahey* v. *L.P. Investors,* 774 F.2d 543, 550 (2d Cir. 1985).
[4] *Mayers* v. *New York Community Bancorp, Inc.,* 2006 WL 2013734 at * 6–7 (E.D.N.Y. 2006) and 2005 WL 2105810 at * 11–14 (E.D.N.Y. 2005) (decisions not reported in F.Supp.2d).
[5] *See, e.g.,* "Direct Deposit: Frequently Asked Questions," Social Security Online, http://www.socialsecurity.gov/deposit/DDFAQ898.htm.

ment 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 and the beneficiaries' funds are frozen by the recipient bank. 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 broad

Many state court orders are broad and encompass all funds. These orders may specify that the financial institution is to freeze and then hold 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 faces a legal risk if it fails to take action under state creditor laws and/or court issued garnishment orders. Under some of these laws, a bank can be held liable for the entire amount of a debt that a creditor is seeking to collect if the bank fails to comply with a garnishment order.

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, such as social security and SSI. The FDIC is committed to addressing this important issue, and Chairman Bair and Vice Chairman Gruenberg have directed us to work with the industry, consumer groups and our fellow regulators to develop solutions. In August 2007, Chairman Bair proposed that the Federal Financial Institutions Examination Council (FFIEC) Taskforce on Supervision form a working group to address garnishment of exempt public benefit payments. The FDIC played a leadership role in forming an interagency working group which includes the banking agencies and representatives from the Office of Management and Budget (OMB), SSA, VA, and the Department of the Treasury.

The interagency working group considered the merits of a number of policy options. Although the FDIC and other bank regulators currently lack adequate legal authority to effectuate a comprehensive solution to the issues raised by garnishment, we initially offered a proposed list of practices for banks to use as guidelines when faced with processing garnishment orders. The proposed guidance was published in the Federal Register on September 28, 2007, and afforded a 60-day period for public comment. After receiving 77 public comment letters, it was clear that the best practices guidance would not provide a sufficient response to the issue and that regulatory or legislative action was necessary to address the concerns of both the financial institutions and consumers. The proposed guidance, however, sensitized financial institutions to the issues regarding garnishment and sought their more active involvement in the resolution of the issues surrounding garnishment orders.

At the beginning of this year, the banking agencies and the benefit paying agencies met with representatives from the banking industry. The bankers described detailed procedures used to process garnishment orders, as well as complexities they encounter as a result of multiple recordkeeping systems and varying state laws and civil procedures. The agencies also met with consumer advocacy groups to discuss the impact of garnishment orders on elderly and disabled consumers and their perspective on possible solutions to the garnishment issues. At the same time, the FDIC was taking steps to increase public awareness of the exemptions from garnishment that are available to benefit recipients under federal law.

Possible Solutions to Address Garnishment of Exempt Federal Benefits

The FDIC's goal in developing solutions to address many of the significant issues raised by garnishment of federal benefits has been to find approaches that will address the legitimate interests of both benefit recipients and their financial institutions. After consulting with the other agencies, consumer groups and the banking industry to build a consensus on an optimal solution to address these issues, the FDIC would suggest consideration of two alternatives.

SSA, VA and the Treasury Department have authority to promulgate rules under their current statutory authority. As the agencies responsible for implementation and interpretation of these benefit programs, they are in the best position to address the garnishment exemption issue. Rulemaking by these agencies on this issue would provide bank regulators with legal authority to enforce such rules under current enforcement authority.

The FDIC suggests that the potential solution could be similar to statutes currently in effect in Connecticut and California.[6] The Connecticut law directs a bank that has received a garnishment order to leave the lesser of $1,000 or the amount on deposit on the date the garnishment is served if "readily identifiable" exempt funds have been deposited by direct deposit into the account during the 30-day period prior to service of the garnishment. Under the California law, when a civil garnishment order is served on a California financial institution, if the deposit account receives direct deposits of Social Security benefits or other specified types of public benefits, the account enjoys an automatic exemption, without the account owner having to seek a stay of the order, subject to certain dollar limitations set forth in the law:

- $1,225 where one depositor is the designated payee of a directly deposited public benefits payment other than Social Security benefits payments.
- $2,425 where one depositor is the designated payee of directly deposited Social Security benefits payments.
- $3,650 where two or more depositors are the designated payees of directly deposited Social Security benefits payments.

These approaches give the customer access to funds while the dispute is resolved and provide a comparatively simple, clear rule for banks that receive garnishment orders. The FDIC believes that such an approach makes sense and should be applied nationwide to provide access to vital funds for beneficiaries of exempt benefits. We also believe that it is important that beneficiaries receive prompt notice with clear information regarding their rights in getting their exempt funds unfrozen as quickly as possible.

The issue of commingling of exempt and non-exempt funds similarly could be addressed by a statutory provision mandating 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.

Another alternative would be for Congress to amend Section 207 of the Social Security Act and similar statutes.[7] However, it appears that ample authority exists under current law to address the issues surrounding garnishment through rulemaking.

The FDIC will continue to work with the benefit-paying agencies and other federal agencies to improve the garnishment system to ensure the fair treatment of beneficiaries through a structure that provides clear guidance to financial institutions and state judiciary systems.

Payday lending issues

The FDIC has long been troubled by the impact on consumers of costly short term credit, such as payday lending. Typically, these loans are characterized by small-dollar, unsecured lending to borrowers who are experiencing cash-flow difficulties and have few alternative borrowing sources. The loans usually involve high fees relative to the size of the loan and, when used frequently or for long periods, the total costs to the borrower can rapidly exceed the amount borrowed. Consumers using this product typically have bank accounts because payday lenders generally require a post-dated check from the consumer for the loan's repayment.

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[6] *See* CONN. GEN. STAT. 52–367b (2007); CAL. CIV. PROC. 704.080 (2004).

[7] Similar amendments could be made to the law regarding VA benefits and other legally protected federal benefit payments.

The FDIC has issued a series of guidance statements on this type of lending. The most recent guidance, issued in 2005, discourages institutions from repeatedly renewing short-term, high-cost loans, instead encouraging institutions to offer customers alternative longer-term credit products that more appropriately suit the customers' needs. FDIC guidance had the effect of essentially stopping FDIC-supervised institutions from making high-cost payday loans.

Further, in March of this year, the FDIC launched a two-year small-dollar loan pilot program to identify effective and replicable business practices to help banks incorporate affordable small-dollar loans into their other mainstream banking services. Lending in this program follows in large measure the Guidelines on Affordable Small-Dollar Loans issued in June, 2007. These guidelines provide a means to enable insured institutions to better serve an underserved and potentially profitable market while helping consumers avoid, or transition away from, reliance on higher-cost payday type loans.

The movement to electronic funds transfer and direct deposit of benefit payments in many ways has been a favorable development. It can provide added convenience and security for benefit recipients over the traditional payment of benefits by check. However, it can also enable payday lenders, check cashers and pawn shops to profit from consumers who lack traditional banking relationships (such as a checking account in the usual payday lending relationship) and provide a means to control beneficiaries' flow of funds. In order to electronically transfer benefit funds, a bank routing number is required. As such, a cottage industry has grown up around electronic benefit payments that allow payment distribution firms to use the banking system to capture control of consumers' benefits.

Reports have described situations where unbanked individuals, including recipients of federal benefits, have completed Standard Form 1199A ("Direct Deposit Sign-up Form") that authorizes payment distribution firms, check cashers, pawn shops and payday lenders to deposit their funds in a bank account that these firms exclusively control. These relationships are often created by a complex web of financial participants, including ultimately the depository institution where the funds are held. Consumers who receive their federal benefits payments through these processes may also be subject to unnecessary fees that could be avoided through simpler payment methods, such as the direct deposit of their benefits into a personal account with the beneficiary's own bank.

The FDIC is very concerned about bank involvement and has been actively reviewing these relationships and practices. At this time, it appears that a limited number of financial institutions supervised by the FDIC, as well as other federal and state banking regulators, are involved in these arrangements. We are currently investigating to determine the extent and type of the relationships between FDIC-supervised financial institutions and payment distribution firms, check cashers, pawn shops, and payday lenders. These relationships raise a number of issues, including appropriate disclosures to consumers, the ability of consumers to maintain control over their funds, compliance with various federal and state consumer protection standards by financial institutions and whether the accounts are properly structured to qualify for deposit insurance protection. If warranted, the FDIC intends to use our supervisory and enforcement tools to ensure the protection of consumers.

While we continue to look at FDIC-supervised institutions' roles with respect to the benefit payment distribution mechanism, which is usually a depository relationship, we also support the SSA's willingness to address the challenges from the benefits distribution perspective. Recently, the SSA issued a Notice of Request for Comments on the use of master/sub accounts for the payment of benefits. In the Notice, the SSA indicated that it anticipates changing its current procedure in light of concerns about how high interest lenders are using this account procedure. With the information being gathered from the Notice and from our own review, the FDIC stands ready to provide any assistance to SSA that it might request and to implement any restrictions on these accounts that SSA might establish.

Also, we believe that with the introduction of the Direct Express Treasury debit card program, participating beneficiaries will maintain control of their benefit funds, thus, preventing the redirection of benefits to potentially unscrupulous entities.

Conclusion

Congress intended that Social Security and other federal benefits not be subject to garnishment, except in certain specific cases. However, it is the freezing of funds that causes significant harm to recipients of federal benefits programs. Moreover, the garnishment process is primarily controlled by state law. As currently implemented, this process causes 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 helping solve the garnishment issue. We have engaged consumer groups, the banking industry, and other interested federal agencies in trying to achieve a workable solution. The 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 also is very concerned about bank involvement in practices that facilitate high cost activities, such as payday lending. We are particularly reviewing how these practices can transfer control of a consumer's benefits to a third party. If warranted, the FDIC intends to use our supervisory and enforcement tools to ensure the protection of consumers.

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

Mr. POMEROY. It seems to me that we have got three agencies, each saying this is a problem, we are committed to working on it, and yet nothing has been done. I would just throw out for the three of you, when is your evaluation of how quickly Congress can expect some regulatory action?

First of all, I guess, Mr. Fritts, you have indicated it would be your view at FDIC on—believes it has ample authority, working with other relevant agencies under existing statutory law, that these matters, the concerns raised in this hearing, could be addressed through a regulatory function of the executive branch. Is that your view?

Mr. FRITTS. Yes. We believe that the SSA has the authority to implement a regulation based on the Social Security Act that could provide a clear-cut, practical solution to the garnishment issue.

Mr. POMEROY. Well, in the interest of trying to provoke a fight, let me just ask SSA to respond to that.

Ms. LACANFORA. We fully support resolving this problem as expeditiously as possible.

We do not have the ability to create banking policy. The role of the Social Security Administration is to adjudicate claims for benefits. It is our statute, that's true, and we could promulgate regulations under that statute, and we have, and we did that in 1980, as it relates to our role, administering the statute.

If we were to promulgate regulations on our own, we would simply restate what is already in the statute. As Ms. Saunders said, the statute is very clear.

So, I think we're on the right track working closely with Treasury on a joint solution. Neither Agency can resolve the problem alone, and it has taken us some time to come to consensus on that, and I think we've reached that point. We fully support the effort here, and we're willing to do whatever we can, under our authority, to promulgate regulations and solve the problem.

Mr. POMEROY. I just observe I think it's really incredibly lame of FDIC to suggest that SSA's evaluation of the statutory bars laid out in their Q&A that used to be on their webpage was somehow instructive for interpretation in Federal law by FDIC. I mean, a ban is a ban.

To me, it that point becomes a banking issue, relative to whether Federal law is being adhered to or not. I don't see—I mean, I am amazed that the general counsel's office of FDIC found that they had to somehow wait and have SSA tell them whether this was a bar, or could be used as an affirmative defense, or be somehow instructive in that way.

Mr. FRITTS. Well, I believe it has been SSA's position for a long time that it is an affirmative defense.

Mr. POMEROY. Is that SSA's position, or do you believe it's a bar?

Ms. LACANFORA. The statute is clearly both a bar and a defense against garnishment.

Mr. POMEROY. Okay, that one is laid to rest. Let there be no doubt at FDIC, SSA says it's a bar, right? Any question about that?

Mr. FRITTS. No, Sir.

Mr. POMEROY. Right. I mean, so if it's a bar, then what has been the reason for all the delay at FDIC when the Chairman of the Financial Services Committee writes in June of 2007 a series of questions on these issues, that we still don't have action within FDIC?

Mr. FRITTS. One thing I think is important to understand is that, ultimately, the creditors do not get the funds from the borrowers and the deposit account holders.

As the state legal process plays out, the money is not ultimately garnished. The problem is, in the intersection of the state law and the Federal law, you have the state legal process that you have to go through, and the banks are required to freeze that money by the orders of the state courts until such time as that process plays out.

That's why the FDIC has, for over a year, taken a leadership role. We started a group, inviting the SSA, the VA, and others suggested a solution that was workable. We also engaged the consumer groups, and the banking industry.

We believe we have found a solution to this process. When you specify that a certain amount of money would be available to the account holder, you provide clarity and simplicity. You don't have to worry about the exceptions, to a great degree, that are within the law. You don't have to concern yourself about the commingled funds that are in the account, which make it very difficult to determine what funds are exempt and what aren't. You have a simple methodology that allows for the protection of those beneficiaries' funds in a way that allows access to a portion of the funds while the legal process still plays out.

Mr. POMEROY. There is some dispute, I guess, in what the Committee has heard this morning, relative to whether or not deposits made on Social Security funds are easily and quickly identifiable. I know some banks have—I believe the inspector general said they would be electronically identifiable, very easily identifiable by the financial institutions.

But in any event, what has been the receptivity of your proposal of going with, like, a California or Connecticut approach?

Mr. FRITTS. Well, I can just say—and I don't want to speak for any other folks that aren't here at the table—but as you heard in the previous testimony of the various consumer interests, they are supportive of that as one solution.

I have discussed this with the banking trade associations, at least the major one, and they are supportive.

Mr. POMEROY. It just doesn't seem like this is very far along. I mean, it seems that it's been a growing problem. There have been hearings, letters, articles, and it seems to me as though we're still at a pretty formative stage, in terms of a definitive response. Mr. Grippo, can you address those concerns?

Mr. GRIPPO. Sure, sure, let me comment on that. I would like to say a few things.

First, I think the primary reason why no action has been taken to date is some of what you have heard, that there is a division of authority here. We have bank regulators that would enforce certain rules, we have the Treasury that regulates Federal payments, we have SSA with the anti-garnishment statute itself. I think all three parties need to work together on a solution.

In fact, that would be the main message I would deliver here today, that we have basically come to an agreement that all parties need to work together to issue appropriate guidance here. I think——

Mr. POMEROY. What I see, Mr. Grippo, is that in August of 2007 Commissioner Astrue asked OMB to have a multi-agency process. I know FDIC, I think, has asked for one. Is something underway with a likely decision point, where we're going to have an administrative response on a multi-agency basis?

Mr. GRIPPO. Yes. We have agreement with the Social Security Administration to work on this. I think over the last——

Mr. POMEROY. When can we expect something?

Mr. GRIPPO. Well, I don't know when we could expect a specific rule or policy——

Mr. POMEROY. Has this inter-agency process effectively begun yet?

Mr. GRIPPO. I think it has, and I can outline, at a high level, the solution that we at Treasury think needs to be implemented.

Specifically to this problem of illegal garnishment of accounts, something needs to be done—and I think this can be done either through a regulation or through policy guidance—that goes to the financial institution practice of freezing accounts. We need to ensure that financial institutions do not freeze all of the money in an account, and make some of it available to the beneficiaries.

We need a means of explaining to the financial institution how they should measure the amount of funds they should not freeze, which goes to the question of whether exempt funds can be identified, and I think there are some straightforward rules and guidance we can give the banks to identify those funds.

We need guidance to banks that allows them to know that they will have a safe harbor, which is to say if they do not freeze the account, and they allow withdrawals to the account, that they would not be held in contempt of a state court, or they would not be liable for the withdrawal of the account. So, that needs to be part of the solution.

I think we need a solution that covers all types of Federal benefits. These anti-garnishment statutes exist throughout the code. It's not just with Social Security benefits, but VA benefits, civil service retirement benefits. So, I think part of the solution needs to be to tell banks what they need to do in all those cases.

So, those four or five things I've outlined, I think, are what this inter-agency group is focusing on, and what we want to give force and effect to.

Mr. POMEROY. I think that sounds responsible, sounds like a good start. Is—end of summer we see a proposed rule?

Mr. GRIPPO. I would hate to give a sp ecific date. I can tell you we have agreement to do this, and we have——

Mr. POMEROY. Wait. Our oversight function, really, is only meaningful provided when we get specifics. I mean, discussions out there, people are thinking about, and we're agreeing to move forward doesn't provide, at the end of the day, anything, in terms of a response.

We want the rule, we want the proposed rule, so we can go through the administrative promulgation process, and be done.

Mr. GRIPPO. We understand that, and we are ready to begin work on that immediately, along the lines of what I have just outlined.

I can't give a specific date. We do need to talk to several of the other benefit agencies. We need to involve financial institutions, we need to involve the banking associations, which are not getting a voice here today. So, that coordination process prevents me from giving a specific date for a proposed rule, or for specific policy guidance, but——

Mr. POMEROY. I'm not the Chairman, I'm just filling in for one. I would ask that—I would suggest to the Chairman, if he wants to have—if we have payday lenders and banks that are freezing all these accounts, they want to have their day, I would be more than happy to hear from them and ask them a question or two.

We will be leaving in—for August recess, coming back in September. I would also suggest to the Chairman I think we need to take a look at some proposed rules that are out there, or have you back to tell us how we're coming on getting those proposed rules written. I really think that time is of the essence, we've got to move.

That would conclude my questions. Ranking Member?

Mr. JOHNSON. Thank you. I never have seen an agency having some hesitation about writing rules before, have you?

Ms. LaCanfora, can you put some numbers in the pot for us? For those watching the hearing, and who may be reading, about how many payments does SSA send out each year?

Ms. LACANFORA. Social Security distributes about 55 million payments to beneficiaries each month. That's about 650 million payments a year, and the outlays on that reach about $650 billion a year.

Mr. JOHNSON. How many complaints related to non-bank financial service providers have you gotten each year?

Ms. LACANFORA. Well, there are two different issues here. First, the master/sub-accounts, and then the garnishment issue.

On master/sub-accounts, we don't track at a local level the number of complaints that we have gotten. We have had a handful of isolated incidents, or isolated complaints, over the 10-year period that we have allowed master/sub-accounts to be in existence, and we have resolved those promptly.

Mr. JOHNSON. When you say isolated, what do you mean?

Ms. LACANFORA. A handful. A handful of——

Mr. JOHNSON. Okay.

Ms. LACANFORA [continuing]. Unrelated instances.

Mr. JOHNSON. Go ahead, thank you.

Ms. LACANFORA. With respect to garnishment, we don't know of any complaints that we have received related to the freezing or garnishing of bank accounts. That doesn't necessarily mean that that's any indicator of the scope of the problem, since we would not be the traditional place that a beneficiary would come to make such a complaint.

Mr. JOHNSON. Where would they put the complaint?

Ms. LACANFORA. They might complain to the financial institution.

Mr. JOHNSON. Oh, okay. Yes, well, I would think they would come to you, too. How many complaints are related to frozen accounts each year, do you know?

Ms. LACANFORA. We don't have any record of any complaints coming to Social Security about frozen accounts. Again, I don't think we would be the first place that a beneficiary might go for that.

Mr. JOHNSON. Where would he go, you think?

Ms. LACANFORA. They might also go, as Ms. Saunders said, I think, to legal services in their local community.

Mr. JOHNSON. What is the process and outcome for responding to complaints from Social Security?

Ms. LACANFORA. In the instances where someone has reported to us that there has been an unauthorized re-enrollment by a lender of the individual's direct deposit, we would work with that individual, and we either issue a letter—or, in some cases, we contact the lender directly—to make sure that they're aware that that is contrary to our policy. In all instances, the practice has stopped.

We also have the ability to actually block use of the routing number for that financial institution. We have not had to resort to that as of yet.

Mr. JOHNSON. When an account is used properly, do they—do you think that provides an advantage to the beneficiary?

Ms. LACANFORA. There is certainly an appeal for many beneficiaries in using a master/sub-account, primarily because these are individuals who often don't have access to traditional banking services. So, in that respect, yes.

Mr. JOHNSON. Okay, thank you. Mr. Chairman, I am going to terminate now, because of the floor activity, and turn it back to you.

Mr. POMEROY. Thank you, Mr. Johnson.

Mr. JOHNSON. Thank you very much.

Mr. POMEROY. I am going to yield the Chair to Ms. Tubbs-Jones, and I will also be keeping an eye on that vote.

Ms. TUBBS-JONES [presiding]. This is the only way I get to be in charge of this Committee. Everybody is going to run and vote on a Medicare bill and I'm going to stay here and ask my questions. I'm in charge, I love it.

But let me say this. Ms. LaCanfora, how long have you been with your agency?

Ms. LACANFORA. Twelve years.

Ms. TUBBS-JONES. Twelve years. How long have you been in the role that you're in right now?

Ms. LACANFORA. Almost one year.

Ms. TUBBS-JONES. Almost—I find it almost incredible that you could sit here and say to me that you have had only a handful of complaints, and that garnishment is not an issue. Maybe it just doesn't come to your desk. Who else would be—have oversight on this issue?

Ms. LACANFORA. Let me clarify. I, in no way, intend to diminish the impact of garnishment on a beneficiary. We acknowledge that it's a very serious problem. The fact that we, at SSA don't know of any complaints, doesn't mean that it's not a very significant problem. We simply don't have a way of tracking these accounts at the local level.

But as I said, I would think that perhaps the banking industry would know of the complaints, because they would be the first line of defense against a complaint. Then, secondarily, the legal service advocates in the local community would know.

Ms. TUBBS-JONES. You know, I think this is the most preposterous thing, that the people of America, the Social Security folks, recipients, are sitting here saying, "Who is on first?" Now, whose job is it? Whose responsibility? Do we need to issue—not issue, pass a law that requires each of these agencies to sit at the table and understand the impact of your decision-making?

All of you understood that when we decided to go to direct deposit, it was going to present a problem for those who were unbanked. Somehow, we decided, "Well, we will wait to see what the problem is, before we implement a process to assist these folks."

I am a former municipal court judge, a formal general jurisdiction judge, and I can remember sitting in my court room and people coming in, complaining. "They're garnishing me. This is my Social Security check. They're not supposed to be able to do this." We blame the state law, we blame everybody. Somebody has got to take ownership of this issue, on behalf of the people that we all represent.

We can't keep—you know, the thing about being on this Committee, which I love, is how we sit and say, "Well, we're talking, we're going to"—"I'm going to get you an answer immediately, Congresswoman." I'm waiting, and waiting, and waiting, and I haven't gotten an answer. All I want to say is, "Fix it."

Fix it, fix it. Stop talking about what we might be able to do, what we may be able to do. Maybe I can say—require you to meet at 12:00 tomorrow and come up with a response by 30 days later. You own it—and I keep saying you, but we own it. I own it, you own it, your agencies own it, the banks own it. The banks are making beau coup dollars on all kinds of things.

Where is that Article I had? Hold on real quick. In this article—and this is a little bit different than the issue we're talking about. It says—the one that I submitted for the record, called, "How a

Cup of Coffee Can Set you Back an Extra $34," I'm just giving you an example.

It said that, "This year, Bank of America and Washington Mutual hiked their overdraft fees, and raised from five to seven the maximum number of times a customer could be dinged. While many banks say they give customers the right to opt out, the Federal Reserve Board is concerned that the disclosures are inadequate."

Well, in one of the articles it literally told how much money you could receive, and the banks didn't want to get rid of this process, because it was a huge bang for the amount of money that they got in this process.

So, we must find some way to fix the problem, and I must go vote on this Medicare bill. We are recessing until my Chairman gets back.

[Recess.]

Mr. POMEROY [presiding]. All right, I very much thank you for staying.

All right, I really didn't get to pursue in my earlier inquiry this business of master account. I would like SSA to discuss what the—I understand the commissioner is concerned about the information that was revealed in the Wall Street Journal article, and has initiated action. I am wondering where that's at.

Ms. LACANFORA. We put a Federal Register notice out in April, and the comment period for that Federal Register notice closed last Friday—that's June 20th. We received numerous comments, and we're in the process of reviewing them now.

We are very much open to modifying or potentially eliminating SSA's use of the master/sub-account policy. That is, of course, an industry-wide process that is not specific to SSA benefits. We do allow them, under our policy. So, as we look forward and review the comments, we will be looking to modify it in a way that protects beneficiaries more fully.

Mr. POMEROY. Can you give us—can you expand on that?

Ms. LACANFORA. Well, one option would be to eliminate the use of master/sub-accounts completely. Now, that's an industry practice, so it's far broader than just Social Security deposits. For purposes of Social Security deposits, we could cease the use of the master/sub-account process completely.

Another option would be to keep the process in place for certain beneficiaries, where it might be useful and beneficial to them. For example, we talked earlier about individuals who have taken a vow of poverty, and for them it might be something that we want to modify or keep in place. So, there are various options, and we're going to work through the comments as quickly as we can to come up with what the policy should be.

Mr. POMEROY. Could you identify, for example, the master/sub-account where there is usurious interest rates and—essentially, could you narrowly tailor your prohibition to the payday lender crowd, and get at it that way?

Ms. LACANFORA. That would be quite difficult to do something like that, we would certainly need to work with Treasury and the bank regulators since we at Social Security don't have the authority to regulate the banking industry in that way.

Mr. POMEROY. But——

Ms. LACANFORA. Yes?

Mr. POMEROY. It really wouldn't be. They would be ineligible for master/sub-account arrangements. I mean, you do have jurisdiction over the master/sub-account.

Ms. LACANFORA. We have jurisdiction over whether we permit the use of a master/sub-account, yes.

Mr. POMEROY. Can you then, therefore, draw distinctions on which master/sub-accounts you permit, or specifically, which master/sub-accounts you don't permit?

Ms. LACANFORA. That is a possibility that we could consider, yes.

Mr. POMEROY. I would encourage you to do that. It would seem to me that might be the quickest way you could respond to it. I appreciate and share the commissioner's concern, relative to this particular universe.

Ms. LACANFORA. Okay.

Mr. POMEROY. Mr. Lewis, glad you came back. Do you have other questions?

Mr. LEWIS. Just one more question.

Mr. POMEROY. Please.

Mr. LEWIS. Thank you, Mr. Chairman. You know, I don't have a problem with people having a choice, making personal decisions about their money. I want to go back to the fact that those financial institutions, if they're held accountable for their actions, if they're held accountable for going forward with garnishment of SSI payments, then they need to be dealt with, and they need to be dealt with in a severe way, because that's the law.

I want to go back to Mr. Fritts. You know, the FDIC regulates the banks. The law is pretty clear, that SSI payments are exempt from garnishment. I understand what you're saying about setting aside a certain amount of money, but the money that should be set aside is the money that has been exempt, period. You don't have to set aside a certain amount for a house payment, or whatever. The money that is set aside that cannot be used for garnishment purposes would be just simple, it's the SSI payments. So, that shouldn't be a problem.

On the fact whether you can regulate or not, I think that—this is Federal law. I think Mr. Johnson alluded to the fact that he is—you know, it's kind of rare when Federal regulatory agencies have a problem with regulating. I mean, that seems sometimes to be a problem around here, Mr. Chairman, that we pass legislation and then the regulators write the regulations on it, and sometimes they miss the intent. I don't see how you can miss the intent of the exemption of SSI payments from garnishment.

So, the only thing I think that maybe we might be responsible for here would be setting aside state law that would hold banks in contempt, the courts holding banks in contempt of not following through on freezing those accounts. That would be the only thing that possibly I could see. I don't see why the FDIC cannot regulate the banking industry on a Federal law that says those accounts are exempt from garnishment. I just—I don't see that.

So, Mr. Fritts, maybe you can explain that to me.

Mr. FRITTS. Sir, it's clearly a problem, no question about that. I want to make clear what the problem is. The problem is the freezing of the accounts, more than it is the garnishment. It's the state court system that controls the garnishment process.

The bank is the keeper of the funds in the account. Most of the accounts of beneficiary recipients include the exempt funds and other funds that customers get from whatever source. The bank is just the intermediary that keeps that person's account.

When they get a duly executed order from a state court that tells them to freeze an account, sometimes they can see that there is only exempt funds in there. They may be able to say, "Look, it's clear, it's only exempt funds," and many banks do that. In other cases, it's not exempt.

Here is the other complicating issue. In many cases, there are exceptions. There are, I believe, five exceptions to the defense.

Mr. LEWIS. Those are pretty specific.

Mr. FRITTS. Yes, they are specific, but the banks can't make the determination about whether they are or not. That's the state court system that makes that judgment.

What we have tried to figure out is a way, a process, that allows simplicity and clarity and in a way that makes sure that the customers have access to their funds, as the state judicial process plays out. That's what we're focusing on.

Mr. LEWIS. Well, again, I think probably the only thing that we can do, legislatively, would be to exempt those financial institutions from those threats from the state.

But, I mean, I think the law is pretty clear that SSI payments are exempt, and banks should understand that, and financial institutions should understand that. If they don't abide by that, then there should be a rule, a regulation that sanctions them for that miscarriage of the law.

Mr. FRITTS. We agree, there needs to be a regulation. It needs to be clear. We will enforce it.

Mr. LEWIS. Okay, thank you. That's all I have.

Mr. POMEROY. I think this hearing has demonstrated bipartisan concern on this issue. There really has been no distinction, one side of the dais versus the other, in terms of concern.

I would ask that the majority and minority staff of this Subcommittee convene conference calls with the agencies on a monthly basis, going forward. When we're back after Labor Day, we will see where we're at, whether or not further discussion in a hearing format would be useful. Or, hopefully, we will just be well down the track on a resolution that has brought consensus.

So, I thank you very much for the information you brought us today, and look forward to seeing your work product, going from here. Thank you very much. Hearing adjourned.

[Whereupon, at 12:56 p.m., the hearing was adjourned.]

[Submission for the record follows:]

The Community Financial Services Association of America, statement

The Community Financial Services Association of America (CFSA) submits this statement for the record to address the issue of use of master/sub accounts by payday lenders which was considered by the subcommittee at a hearing on June 24, 2008. The CFSA comprises more than 150 member companies that represent over half of the estimated 22,000 payday advance locations nationwide. CFSA promotes state and federal laws that balance consumer choice with consumer protections, and it enhances consumer protections provided by existing laws by requiring its members to comply with a set of responsible lending and collection practices called the CFSA Best Practices.

Payday lenders do not use master/sub account arrangements to receive social security benefits as security for the loan in conducting their payday lending business. Payday lending is regulated by the states, is a specific type of lending authorized under state law, and is governed by very stringent laws and regulations which do not permit establishing master/sub account arrangements as described in the February 12, 2008 *Wall Street Journal* article or the Social Security Administration's recent request for data on this issue.

The term "payday lender" has been used by many organizations to describe a wide variety of lending activities and check-cashing activities that are not payday lending. In fact, one of the problems with the *Wall Street Journal* article is that it used the term "payday lenders" to describe lenders who are not licensed as payday lenders. Even the data request from the Social Security Administration on master/sub account arrangements describes the issue in the context of "payday lenders who solicit social security beneficiaries to take out high-interest loans." "Payday loan" and "payday lender" are terms of art which are defined in state law. A payday loan is generally understood to mean a small-denomination, single-installment loan that matures on the borrower's next payday and is paid by the borrower's cash, personal check, or automated clearinghouse authorization. As we understand the activity, the master/sub account arrangement is a practice in which a social security recipient authorizes a third party to receive the recipient's social security benefits check under a master account with individual sub accounts in the recipient's name. In its request for data, the Social Security Administration states, "Based on the loan agreement between the beneficiary and the loan company, we may authorize the deposit of benefits directly into the loan company's master account. The loan company then deducts the loan principal, fees, and interest before depositing the remaining benefits into the beneficiary's sub account." This scenario cannot happen with a payday loan under state law. State payday loan statutes comprehensively regulate payday lenders and control, among other things, the type of collateral that a lender may accept as security for a payday advance. Generally, these statutes permit a borrower to pay a payday advance only with cash, personal check, or ACH authorization. A third-party check is not acceptable.

Payday lenders sometimes obtain a recipient's authorization to repay a payday loan with a single (i.e., one-time only) electronic debit. In such cases, the recipient signs a loan agreement in which the recipient gives the lender written authorization to electronically debit, on the loan's maturity date, the same recipient-owned bank account into which social security benefits may be deposited. ACH authorizations are utilized by depository institutions and other lenders for repayment of all types of loans and other obligations. Any effort to prohibit a lender or depository institution from electronically debiting a recipient's bank account into which social security benefits may be deposited would have a paralyzing effect on tens of thousands of financial intermediaries that currently engage in electronic commerce with social security recipients. A borrower who authorizes electronic debits from his or her bank account has many protections under federal law, such as being able to revoke an ACH authorization at any time. In addition, federal law also prohibits a lender from requiring a borrower to deposit social security benefits into a particular bank account. Under the EFTA and Regulation E, a person may not condition a recipient's receipt of social security benefits on the recipient's agreement to establish an account with a particular financial institution. Also, under EFTA and Regulation E, a lender may not condition its extension of credit on a borrower's agreement to pay the obligation with recurring electronic debits. In summary, banking and payments laws already provide comprehensive protections to any social security recipient who chooses to electronically repay a loan from the same recipient-owned bank account that also receives social security benefits.

Since the emphasis of this hearing is on seniors who receive social security benefits and who might also take out a loan, it may be helpful to the subcommittee members to have a description of typical payday advance customers. Customers of payday lenders come at all income levels. The majority are generally middle-income individuals.

Payday advance customers are generally younger individuals. Two thirds of payday advance lenders are under 45 years of age, and 36.4 percent (36.4%) are under 35 years of age. One in 10 payday advance customers is aged 55 or older. Only 5 percent (5%) or less are 65 years old or older.

One of the underwriting criteria to obtain a payday loan is that customers must have proof of an active checking account with a bank or credit union. This requirement of having an active checking account reduces the number of low-income consumers who are potential customers. More than half (58%) of customers have attended college, and 1 in 5 (22%) has a bachelor's degree or above.

To summarize, payday advance customers are generally middle-income, young-to-middle aged, banked, educated, homeowners, and have at least one other option for credit than a payday advance.

As referred to earlier in this statement, the Social Security Administration has requested data on use of master/sub accounts by "payday lenders." CFSA has filed comments with the Social Security Administration. A copy of those comments is attached.

In conclusion, payday lenders do not use master/sub account arrangements to obtain social security benefits as security for payday loans. To engage in such arrangements would violate state law and would violate the Best Practices maintained by the CFSA with which its members must comply. CFSA feels that while use of master/sub accounts is not a permitted practice under state law, it is a practice, in any event, that should not be engaged in by payday lenders.

CFSA feels compelled to respond to some of the specific comments made at the hearing about the payday advance industry. Rep. Pomeroy, who chaired the hearing, noted that: "The hearing is not intended to foster debate over the general advantages or disadvantages of payday or 'advance payment' loans. Instead, we are looking to learn how to better protect Social Security beneficiaries from being steered into high-cost direct deposit arrangements by check-cashing and short-term loan operations."

Nonetheless, some of the witnesses' testimony focused heavily on attacking payday lending generally. Therefore, while we do not believe that it is appropriate given the Subcommittee's stated intention to submit a full rebuttal in this statement, CFSA does feel that it is important to make three basic points in response to these attacks:

1. Critics of the industry have called for capping payday advance rates at 36% APR.

This would mean that a lender could only charge a fee of $1.38 per $100.00 borrowed, or $4.14 for a typical $300 two-week payday loan.

Operating costs alone—for rent, salaries, etc.—are many times this $1.38 per $100.00 figure, even without including loan losses and a modest profit.

Lenders simply cannot make these short-term small loans for such a small fee, and would have to stop making payday advance loans as has occurred with respect to military personnel when such a limit was imposed.

2. We strongly believe that seniors and other benefit recipients should have the option of choosing a payday advance if they determine it is most appropriate for them.

As noted elsewhere in this statement, only a small percentage of payday advance customers are seniors or benefit recipients. Payday lenders do not target senior citizens and other benefit recipients and do not and cannot by law utilize master/sub account direct deposit arrangements or wage assignments.

Some benefit recipients naturally do have periodic needs for short-term, low-dollar loans. Often, they select a payday advance because they find it to be the best, less costly, available credit alternative.

Using an "apples to apples" APR comparison, payday advances often prove to be the better borrower option. Consider these typical rate examples for several basic short-term credit alternatives when expressed as an APR as opposed to fees: a $100.00 payday advance with $15.00 fee is 391% APR; a $100.00 bounced check with $54.87 NSF/merchant fee is 1431% APR; a $100.00 credit card balance with $37.00 late fee is 965% APR; a $100.00 utility bill with $46.16 late/reconnect fees is 1203% APR; and a $29.00 overdraft-protection fee on $100.00 is 755%.

3. Critics' central focus on high annual percentage rates ("APR") for payday loans is most inappropriate.

The typical two-week payday advance of $300.00 has a fee of only $15.00 per $100.00, which translated to 15% of the amount borrowed. Yet, when this is expressed in APR terms, this becomes 390%, a very misleading figure that causes many people to mistakenly think that an actual 390% interest rate is being imposed for the two-week period.

The 390% APR for a payday advance arises from the fact that the calculation rules of Regulation Z require that one make a totally unrealistic assumption that the $15.00 fee for a two-week loan will be charged every two weeks for an entire year ($15.00/15% × 26 two-week periods = $390.00/390% APR), even though this is not the case.

In fact, not only do payday lenders not allow such repeated loan rollovers, but state laws generally prohibit them entirely, or in some cases allow only one or two.

Thus, this misleading APR calculation results in confusion and misunderstanding, and industry critics tend to exploit this to advance their political and policy agendas.

It should also be recognized that further confusion arises because APR calculation requirements are not the same for all lenders. Payday lenders, for example, must count all interest and fees, but others, such as credit unions, do not have to include various service or administrative fees in the calculation. This leads to "apples to oranges" APR comparisons. However, when all interest and fees are included when calculating the APR, one finds that many forms of short-term credit are more costly than payday loans, as shown by the chart above.