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More Uniformity Sought for Debtor Garnishment

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By Maria Aspan

The garnishment of debtors' income often puts depository institutions in a difficult spot, but several states have found ways to make the process less burdensome for banks while strengthening consumer protections.

State laws are inconsistent, however, and federal regulators are collaborating on reforms that would preempt them something that bankers and consumer advocates agree is necessary.

Typically, a creditor or collection agency that has obtained a court judgment will ask the debtor's bank to freeze the funds in his or her account as a first step toward garnishment. Many state laws hold the bank liable for any withdrawals made after such restraining orders are received. The rub is that federal law declares certain funds, like Social Security payments or veterans' benefits, to be exempt from garnishment.

Consumer advocates have long criticized banks for freezing such funds until the customers provide documentation of their exempt status (not to mention for charging the debtor various fees). The banks say their hands are tied by their potential liability under the state laws and by the difficulty of distinguishing between exempt and nonexempt funds that are deposited into the same account.

"People who are on both sides of the issue realize that guidance is needed," said Gregory Taylor, an associate general counsel and vice president of the American Bankers Association. "The situation that we have now is confusing and banks are stuck in the middle."

A bill passed last month by the New York Legislature would simplify matters for banks by forbidding them to freeze the first \$2,500 in a debtor's account if it has received any protected electronic deposits during the 45 days before the bank received the restraining order. The measure, which has yet to be signed by the governor, is modeled on similar laws in California and Connecticut.

Roberta Kotkin, the general counsel of the New York Bankers Association, said her group initially opposed the legislation, but withdrew that opposition after it was amended in two ways: it now would cap the number of freezes a creditor can request to two per account per year, reducing what she called an "overwhelming" stream of restraining notices; and it would clarify that banks are responsible for protecting only those accounts

that receive "reasonably identifiable" exempt deposits.

As amended, the legislation "should create efficiency and not be overly burdensome," Ms. Kotkin said. "The No. 1 concern we had with this process was not to take on liability." The cap on restraining orders would also yield "some savings," she said.

Claudia Wilner, a staff attorney for the New York group Neighborhood Economic Development Advocacy Project, said the bill would make the exemption process "easier for everybody," including banks as well as the often "elderly or disabled" consumers who rely on federal benefits and are harmed by even temporary freezes on such funds. "It's very difficult for those groups to prove that their funds are exempt, and these are the people who are particularly reliant on this money," she said.

Ms. Wilner agreed that current procedures put financial institutions in a bind. "Banks would receive this restraining notice and have to restrain the account or risk being held in contempt of court," she said.

Last month, at a hearing of the House Ways and Means Subcommittee on Social Security, Gary Grippio, the Treasury Department's deputy assistant secretary for fiscal operations and policy, said that his agency, "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."

He did not say when such guidance would come out. Jennifer Zuccarelli, a spokeswoman for the Treasury, said by email Wednesday that she was "not in a position to give a specific date at this point" but "we are working to complete the guidance as quickly as possible."

Bank regulators in September 2007 proposed interagency guidance on "best practices" for preventing garnishment of exempt wages. But Steven D. Fritts, an associate director of the Federal Deposit Insurance Corp.'s division of supervision and consumer protection, said at the hearing that the banking agencies lacked the authority to issue anything with teeth.

Rules issued by the agencies that administer benefit programs like Social Security, Mr. Fritts said, "would provide bank regulators with legal authority to enforce such rules." He suggested that these rules follow the examples of the laws in California and Connecticut, which, like the New York bill, automatically prevent a certain amount of funds from being frozen in accounts that receive exempt deposits.

JPMorgan Chase & Co. and Bank of America Corp. endorsed that model in their comments on the banking regulators' proposed guidance. Andrea Beggs, a senior vice president in JPMorgan Chase's legal and compliance department, wrote, "The California and Connecticut garnishment laws provide good examples of a workable scheme for automatic exemptions, and we would support federal regulations with a similar

approach." Kathleen Kloiber Koch, an associate general counsel for B of A, expressed reservations about several of the banking regulators' proposed guidelines and wrote, "The better approach is a ... process similar to California's rules of civil procedure, under which a specific dollar amount is not held if an account receives direct deposit of benefits."

Mark Tenhundfeld, the ABA's director of the office of regulatory policy, said the reforms in California and Connecticut and the New York bill provide a "workable" blueprint for federal rules.

"If the agencies could come out with a rule that created a safe harbor for banks, created a clear road map and preempted inconsistent state laws, we would certainly support that," he said.

Margot Saunders, a counsel to the National Consumer Law Center, said the New York bill would be "very helpful to recipients with little cost to banks," but there is still a need for "federal regulations that would clearly mandate that banks not freeze or seize exempt funds."

Even some debt collectors are on board. David Cherner, a legal counsel for ACA International, a trade group for collectors, said the New York bill "reasonably balances the rights of creditors and debt collectors to use the garnishment tool as well as consumers to protect assets that are exempt from garnishment." As for proposed federal reforms, "we support uniformity across the country over those exemption standards."

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