Safer than the Mattress? Protecting Social Security Benefits from Bank Freezes and Garnishments

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SAFER THAN THE MATTRESS? PROTECTING SOCIAL SECURITY BENEFITS FROM BANK FREEZES AND GARNISHMENTS

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INTRODUCTION

Social Security benefits play an essential role in enabling beneficiaries to meet their basic needs: Approximately one-third of recipients rely upon Social Security for over ninety percent of their income. A brief interruption in access to these funds can cause substantial hardship, rendering it difficult, if not impossible, for a beneficiary to purchase food, pay rent, and provide for basic medical needs. Recognizing these dangers, the Social Security Act exempts Social Security benefits and Supplemental Security Income ("SSI") from attachment or

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1 OFFICE OF RETIREMENT AND DISABILITY POLICY & OFFICE OF RESEARCH, EVALUATION, AND STATISTICS, SOC. SEC. ADMIN., FAST FACTS & FIGURES ABOUT SOCIAL SECURITY, 2008 at 7 (2008), available at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2008/fast_facts08.pdf (providing data showing that Social Security benefits provide over 90% of the income for 32% of all beneficiaries and over 50% of the income for 62% of all beneficiaries); see also United States v. Silk, 331 U.S. 704, 711 (1947) (describing role of social security benefits in protecting beneficiaries from the "hardships of existence"); Helvering v. Davis, 301 U.S. 619, 641 (1937) ("The hope behind this statute [the Social Security Act] is to save men and women from the rigors of the poor house as well as from the haunting fear that such a lot awaits them when journey's end is near."); Social Security Amendments of 1977, Pub. L. No. 95-216, 1977 U.S.C.C.A.N. (95 Stat.) 4155, 4160 ("It has long been recognized that the primary objective of the social security program [is] preventing dependency . . . ").
garnishment\(^2\) by creditors seeking payment for outstanding debts.\(^3\) Social Security benefits—as well as Veteran's Administration benefits, railroad retirement benefits, and other exempt federal benefits—remain protected from garnishment and related procedures even after they have been deposited into a bank account.\(^4\)

\(\text{\footnotesize 2 The terms attachment, garnishment, restraint, and freeze will be used throughout this Article. Their meanings and usage often overlap. For the sake of clarity, these terms will be used with the following definitions. An attachment is "[the seizing of a person's property to secure a judgment or to be sold in satisfaction of a judgment." BLACK'S LAW DICTIONARY 136–37 (8th ed. 2004). Attachment is often used interchangeably with the term "sequestration." Id. at 136. An attachment is effectuated through a freeze or restraint, the act by which a bank renders an account holder's assets immobile. A garnishment is a "judicial proceeding in which a creditor (or potential creditor) asks the court to order a third party who is indebted to or is bailee for the debtor to turn over to the creditor any of the debtor's property (such as wages or bank accounts) held by that third party." Id. at 702–03.}

\(\text{\footnotesize 3 The relevant provision states:}
(a) 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.

Social Security Act § 207, 42 U.S.C. § 407(a) (2006) (emphasis added). Section 407 also applies to Supplemental Security Income benefits through an express reference in § 1631(d)(1) of the Social Security Act. Social Security Act § 1631(d)(1), 42 U.S.C.A. § 1383(d)(1) (West 2009). However, Social Security benefits are not exempt from debt collection to pay outstanding alimony or child support, see 42 U.S.C.A. § 659(a) (West 2009), while Supplemental Security benefits remain exempt even from garnishments involving child support or alimony. Other exceptions to § 407 include: levies to collect unpaid federal taxes, 26 U.S.C. § 6334(c) (2006), or overdue federal tax debts, id. § 6331(h), an election to have benefits withheld to pay a current-year federal tax liability, 26 U.S.C.A. § 3402(p) (West 2009), and withholding of benefits to pay a nontax debt owed to another federal agency, 31 U.S.C.A. § 3716(c)(3)(A) (West 2009). For a detailed treatment of these exceptions and how they interact with other statutory provisions limiting the amount of exempt income that may be garnished when an exception applies, see Allen C. Myers, Note, Untangling the Safety Net: Protecting Federal Benefits from Freezes, Fees, and Garnishment, 66 WASH. & LEE L. REV. 371, 380–85 (2009).

Other federal benefits are also protected from garnishment by separate statutes. These include veterans benefits, 38 U.S.C. § 5301(a)(1) (2006), railroad retirement benefits, 45 U.S.C.A. § 231m (West 2009), and benefits provided through the federal retirement program, 5 U.S.C. § 8470 (2006). The proposal outlined in this Article focuses on Social Security benefits but would provide protections for all of these exempt federal benefit payments.

\(\text{\footnotesize 4 Philpott v. Essex County Welfare Bd., 409 U.S. 413, 416 (1973) superseded by statute, 42 U.S.C.A. § 1333(g) (West 2009). To remain exempt from garnishment, these benefits, when deposited in a bank account, must retain the "quality of moneys" and not become a "permanent investment." Id. In other words, they must remain "readily withdrawable" and available for an individual's daily needs. Id. In}

\(\text{\footnotesize 1128 ST. JOHN'S LAW REVIEW [Vol. 83:1127}
Unfortunately, low-income recipients of Social Security and similar exempt benefits routinely discover that these funds, which they believed were safely deposited in a bank account, have been temporarily frozen or, even worse, permanently garnished at the behest of a judgment creditor. Creditors with a judgment against a debtor serve a garnishment order, in accordance with state law, commanding a bank to attach the debtor’s funds. State procedures typically require a bank to immediately freeze a debtor’s account, denying access while a garnishment order is processed. During this period, the account holder is typically given an opportunity to assert that the funds are exempt from garnishment under federal or, in some cases, state law, and as such, must be released. It can, however, take weeks to adequately establish an exemption claim and regain access to a frozen account. If an exemption is not timely asserted, the funds are often transferred to the judgment creditor.

Philpott, the Court extended its decision in Porter v. Aetna Casualty & Surety Co., 370 U.S. 159 (1962), which held that Veteran’s Administration benefits remain exempt so long as they “are readily available as needed for support and maintenance, actually retain the qualities of moneys, and have not been converted into permanent investments.” Id. at 162. In addition to funds deposited into checking and savings accounts, courts have found that Social Security benefits do not lose their exempt status and become permanent investments when deposited into a certificate of deposit. E.W. ex rel. J.R. W. v. Hall, 917 P.2d 854, 858–59 (Kan. 1996).


See infra notes 46–50 (describing state garnishment procedures).

This process is described by the Third Circuit in Finberg v. Sullivan: The attachment of property held by a garnishee is... a provisional measure serving the judgment creditor’s interests by preventing transfer or concealment of the property before the creditor can execute a final seizure. The attachment affects the debtor’s interest by depriving her of the continued use of her property. 634 F.2d 50, 57–58 (3d Cir. 1980).

Courts have found that due process requires an opportunity to be heard after an attachment. See, e.g., id. at 59 (“[A] judgment debtor... must have an opportunity to assert and adjudicate claims of exemption promptly after the imposition of a freeze.”).

See 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 ST. J.,
do not know that their funds are exempt under federal law. They may also fail to assert an exemption because they find the process too daunting or time consuming.\textsuperscript{10} As a result, funds can be completely and permanently removed from their account and transferred to a judgment creditor.\textsuperscript{11}

Since these benefits often play an essential role in enabling a recipient to meet his or her basic needs,\textsuperscript{12} even a brief interruption in access can cause substantial hardships. Social Security recipients whose bank accounts are frozen often experience major difficulties during the weeks or even months it may take to prove their funds are exempt and regain access to the federal benefits they rely upon for subsistence. Hardships occur even when the funds in an account are not permanently garnished and transferred to a judgment creditor. One Social Security recipient, during congressional testimony, recounted

\textsuperscript{10} See, e.g., E-mail from Sue Donaldson, Executive Director, Wash. Appleseed Ctr. for Law in the Pub. Interest, to the Office of the Comptroller of the Currency on Proposed Guidance on Garnishment of Exempt Federal Funds, (Nov. 26, 2007), http://www.waappleseed.org/article_252.shtml (“From our work with disadvantaged people in the State of Washington . . . we know that it is frequently the case that debtors who have only exempt funds in their bank accounts do not know how to protect their accounts from garnishment.”).

\textsuperscript{11} See Frozen Out: A Review of Bank Treatment of Social Security Benefits: Hearing Before the S. Comm. on Finance, 110th Cong. 3–4 (2007) [hereinafter Frozen Out] (testimony of Margot Saunders, Counsel, National Consumer Law Center) (asserting that, due in part to the difficulty many benefit recipients face in obtaining counsel and asserting their exemptions, “[t]he 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”) (italics in original), available at http://finance.senate.gov/sitepages/hearing092007.htm; id. at 4 (testimony of Johnson M. Tyler, SSI Unit Director, South Brooklyn Legal Services) (“[G]etting an account unfrozen, even when it contains only exempt Social Security payments (that the creditor has no legal right to) is time consuming, cumbersome, and likely to fail if the debtor is unrepresented.”); Schultz, supra note 9 (citing legal aid representatives who claim that creditors sometimes “appear to automatically deny exemption claims and drag out the process until the oldsters give up or die”); Glenn Howatt & Pat Doyle, Hatch Sues Big Law Firm, STAR TRIB. (Minneapolis, Minn.), Dec. 22, 2004, at 1B (describing suit filed by Minnesota Attorney General alleging that law firm routinely misled state courts and ignored consumer’s claims that their bank accounts contained exempt funds).

\textsuperscript{12} See Frazier v. Marine Midland Bank, N.A., 702 F. Supp. 1000, 1003 (W.D.N.Y. 1988) (“By insulating social security benefits from assignment or seizure, § 407 attempts to insure that recipients have the resources necessary to meet their most basic needs.”) (citing United States v. Devall, 704 F.2d 1513, 1516–17 (11th Cir.1983)).
how he and his wife, unable to purchase food when their account was frozen for twenty-three days, resorted to living off of a ten-pound bag of brown rice. Waverly Taliaferro lost forty pounds during this period. After working for forty years, Viola Sue Kell, a sixty-four-year-old widow, depended on Social Security disability to pay for her basic needs: her mortgage and electricity bill checks bounced when her account was frozen. A frozen account rendered eighty-year-old Elverna Ward unable to purchase the eye drops needed to treat her glaucoma. She also had two checks bounce and could not pay for her rent and Medicare, despite the fact that she immediately faxed the collection firm bank statements proving that her only income was from Social Security. Robert Weise, a seventy-year-old battling colon cancer, relied on Social Security to pay his chemotherapy copayments. When his wife tried to withdraw funds from their account to pay a copayment, she learned the account was frozen. Neither their bank, nor the debt collector, told the Weises, as required by law, that Social Security is exempt from garnishment. In situations like these, suddenly left without any access to their money, Social Security recipients can find the process of proving exemptions and obtaining legal counsel daunting, if not impossible. Some individuals, desperate to regain access to their funds, will agree to payment plans with creditors in exchange for the release of a garnishment order, foregoing the exemptions they are entitled to under law.


14 Schultz, supra note 9.


16 Schultz, supra note 9.

17 Ms. Kell had to travel sixty miles to find a legal services office that could help her regain access to her funds. She then decided to avoid future freezes by receiving paper checks. Id.

Advocates for benefits recipients have contended that these temporary restraints undermine the goals of federal exemption laws. The statutory prohibitions against the garnishment of exempt benefits were motivated by Congress’s acknowledgement that if these benefits “are to meet the most basic needs of the poor, [they] must be protected from seizure in legal processes against the beneficiary.” As a bipartisan group of eight United States Senators declared in a letter to the head of the Office of Management and Budget: “Congress intended for Social Security, SSI, and Veterans’ benefits to provide at least a minimum subsistence for our nation’s veterans, elderly, and disabled. . . . The clear intent and spirit of [the exemption provisions] is to protect these exempted funds for vulnerable beneficiaries.” As federal courts faced with legal challenges to state garnishment procedures have recognized, much of the value of these exemptions resides in their ability to ensure that recipients retain the uninterrupted use of their benefits. The

Social Security Benefits] (testimony of Margot Saunders, Counsel, National Consumer Law Center), available at http://waysandmeans.house.gov/media/pdf/110/sau.pdf (providing appendices presenting case histories of benefit recipients whose exempt funds were frozen); Errol Louis, Editorial, A Bank Hits Below the Belt, N.Y. DAILY NEWS, May 11, 2008, at 33 (recounting story of Social Security recipient who was unable to pay for blood pressure medication after bank froze his account); New York City Department of Consumer Affairs’ Public Hearing on Debt Collection Practices, 107-08 (June 12, 2006), quoted in OFFICE OF FIN. EMPOWERMENT, supra note 5, at 3.


20 Letter from Senator Max Baucus et. al. to Jim Nussle, Dir., Office of Mgmt. and Budget (Nov. 20, 2007), available at http://www.aging.senate.gov/letters/ssgarnishmenttomb.pdf. The letter, also signed by Senators Chuck Grassley, Herb Kohl, Gordon Smith, Christopher Dodd, Richard Shelby, John Kerry, and Claire McCaskill, urged Mr. Nussle to “conduct a multi-agency process” to “issue a rule clarification that will prevent beneficiaries from being denied access to exempt funds.” Id. A subsequent letter from Senators Kohl and McCaskill to Treasury Secretary Timothy Geithner renewed this request, noting that efforts in crafting a solution had stalled. Letter from Senators Herb Kohl and Claire McCaskill to Timothy Geithner, Sec'y, Dep't of the Treasury (May 14, 2009).

21 See Finberg v. Sullivan, 634 F.2d 50, 63 (3d Cir. 1980); Deary v. Guardian Loan Co., 534 F. Supp. 1178, 1188 (S.D.N.Y. 1982). In Finberg, the Third Circuit declared Pennsylvania’s existing post-judgment garnishment rules invalid, holding
2005 bankruptcy reform rendered it more difficult and expensive to file for bankruptcy, making these exemptions even more important. More recently, the international financial crisis has shed new light on predatory lending practices and the dangers they pose to consumers and Social Security beneficiaries in particular. Recognizing these dangers, Congress recently passed new restrictions on the credit card industry, a source of substantial consumer debt.

Further complicating the issue, more than eighty percent of Social Security recipients receive their benefits through direct deposit, in accordance with federal policies that encourage...

in part that they violated the Supremacy Clause. The court found that the procedures in place, which failed to avoid a “significant interruption of access to benefits,” were void under the Supremacy Clause because they stood as “an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” Finberg, 634 F.2d at 63 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).


23 One form of predatory lending, payday loans, are a particular concern for Social Security recipients. See Ellen E. Schultz & Theo Francis, Social Insecurity: High-Interest Lenders Tap Elderly, Disabled, WALL ST. J., Feb. 12, 2008, at A1 (describing how payday lenders, “who pitch loans with effective annual interest as high as 400% or more, can gain almost total control over Social Security recipients’ finances”). Payday lenders target benefit recipients because they have a regular source of income. To avoid laws that prevent benefits from being sent directly to a lender, the lenders forge relationships with banks. Benefits are then directly deposited in the bank, which immediately transfers the funds to the lender, which “then subtracts debt repayments, plus fees and interest, before giving the recipients a dime.” Id. The Payday Loan Reform Act was introduced in Congress on February 26, 2009. The bill seeks “[t]o amend the Truth in Lending Act to establish additional payday loan disclosure requirements and other protections for consumers....” H.R. 1214, 111th Cong. (2009); see also Press Release, House Comm. on Fin. Servs., Subcommittee Hearing to Evaluate Restrictions on Predatory Lending Practices (Mar. 31, 2009), available at http://www.house.gov/apps/list/press/financialsvcs_dem/press033109.shtml (“The bill focuses on the two major concerns with regard to payday loans: the fees charged and the ‘cycle of debt’ that occurs when consumers are not able to immediately repay their loans.”).

electronic deposit in order to reduce government costs. For benefit recipients, however, direct deposit remains both a blessing and a curse. Although it allows individuals quicker access to their funds, direct deposit can render a recipient’s money, once it is deposited in a bank account, more readily accessible to judgment creditors and their lawyers. At the same time, direct deposit holds the potential to improve significantly the implementation of federal protections for exempt benefits. Direct deposits—which are electronically coded—render it easier to identify the source of bank deposits. The potential for banks to identify easily exempt benefit funds has prompted efforts to require banks to examine accounts when they receive a garnishment order and, if an account receives exempt federal benefits, to either refuse the freeze or protect some portion of the funds in the account. The freezing of bank accounts containing exempt federal benefits has received some treatment in the mainstream press and in legal and business trade publications. A few law review articles have briefly referenced the issue, and one recent student note examined the issue in depth. The note provided an extensive review of federal statutory exemptions and state laws governing the garnishment process, with a focus on Virginia. It also discussed Due Process and Supremacy Clause challenges to state garnishment statutes before analyzing a range of possible public and private solutions. This Article, in contrast, focuses

25 See infra notes 57–63 and accompanying text.
26 See infra Part II (discussing relevant state administrative and legislative efforts). These efforts have been driven in part by the concern that current state garnishment procedures either fail to afford account holders adequate due process protections or violate the Supremacy clause. See infra notes 86–87 and accompanying text (discussing motivations for changes in Pennsylvania).
28 Myers, supra note 3, at 374.
29 Id. at 380–93. The Note’s Appendix offers a helpful survey of garnishment provisions in all fifty states and the District of Columbia. Id. at 424–34.
30 Id. at 393–402.
31 Id. at 402–21. The Note contends that federal legislation offers the best solution and advocates a five-part plan with many similarities to the proposal elaborated in this Article. See id. at 403–11. However, Myers also argues that federal agencies could institute nearly the same response as he proposes for Congress, id. at 411, a contention with which I disagree. See infra Part IV.B.2.
on the specific contours of a federal legislative response, expanding on the author's earlier presentation of this policy proposal. In arguing for specific facets of this proposal, it draws upon a careful analysis of similar state solutions and on the critiques and concerns of a range of interested parties.

Specifically, the Article proposes actions that should be taken by Congress and the relevant federal agencies to ensure that the protections provided by the Social Security Act are not undermined by state garnishment and attachment procedures. Numerous states have already attempted to strengthen these protections through legislation and changes in the court rules governing garnishments. At the same time, legal actions in federal and state courts have challenged specific state garnishment procedures. These challenges have primarily contended that state procedures violate both the due process rights of benefit recipients and the Supremacy Clause of the Constitution. The Supremacy Clause argument asserts that state garnishment procedures—by temporarily denying benefit recipients access to their exempt funds—threaten to undermine the policy goals that drive the federal exemption provisions. Although state efforts to protect Social Security benefits have achieved some success, continued reliance on a patchwork of state regulations will produce inconsistent results. Recipients of Social Security and other exempt federal benefits should not enjoy or be denied the protections provided in federal law based on their state of residence. This situation demands a federal

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33 See infra Part II (discussing relevant state administrative and legislative efforts).

response, which will further the policy goals that underpin the exemption statutes and will ensure consistent protections nationwide.

This Article proceeds in four parts. Part I discusses the tension between the Social Security Act's exemption provision and state garnishment procedures. It also examines how the increased use of direct deposit and technological advances in the collection industry exacerbate the dangers that benefit recipients face. Part II examines state attempts to strengthen protections for Social Security, SSI, and other exempt benefits. This brief study of a few representative examples reveals the practical considerations that must inform a viable solution, the concerns of various stakeholders, and the lessons that can be learned from past efforts. The Section concludes by discussing the policies instituted in California, Connecticut, New York, and Oregon, which provide useful models for a federal response. Part III addresses recent discussions of the issue in Congress and among the federal regulatory agencies. This analysis focuses on comments presented in response to proposed guidance by the federal banking agencies regarding garnishment of exempt funds.

Finally, Part IV proposes a federal policy to protect exempt benefits and examines the limitations of possible alternative responses. This policy proposal has five parts. First, and most simply, the relevant benefit agencies and the Treasury Department, which disburses electronic payments, must ensure that electronic deposits are clearly and uniformly coded and identified as exempt when they arrive in a recipient's bank account. Second, ideally Congress, and, if not, the federal benefit or financial agencies, must implement an automatic exemption system; under this system, when an account regularly receives identifiable electronic deposits of exempt benefits, a fixed amount of money in the account will automatically remain accessible to the account holder. Third, Congress should mandate the use of a uniform accounting method—the first in, first out method—for determining the status of any money in an account that exceeds the automatic exemption amount. Fourth, legislation should limit the number of times an account may be frozen and implement a system to ensure compliance with this provision. Fifth, banks that act in good faith to comply with the federal law should be protected from potential liability to either the
judgment creditor or the account holder; at the same time, banks that fail to adequately fulfill their responsibilities under the new legislation—to examine an account and apply an automatic exemption—should face penalties. Part IV concludes with a brief discussion of the unique concerns raised by bank setoffs and overdraft protection programs.

Any fair and effective response to this issue must carefully consider the concerns and interests of benefit recipients, banks, creditors, the federal government, and overburdened state and federal courts. By carefully examining the lessons gleaned from past efforts, the concerns of diverse stakeholders, and practical considerations regarding implementation, this Article provides a blueprint to guide the development of a federal response that will ensure the protection of exempt benefits. The response proposed will further the goals of the Social Security Act by protecting the benefits of many of the most vulnerable Social Security recipients.

I. THE INCREASING DANGERS TO EXEMPT BENEFITS

A. State Garnishment Procedures and Changes in the Debt Collection Industry Have Undermined the Social Security Act's Protections

The total amount of exempt funds that is garnished, that is, completely removed from Social Security recipients' bank accounts and transferred to a judgment creditor, is difficult to determine. A July 2008 report by the Social Security Administration's Inspector General estimated, based on a representative sample of financial institutions, that the 45.9 million direct deposit Social Security beneficiaries nationwide had approximately $177.7 million garnished over a one-year period. The vast majority—$171.4 million—of this money was estimated to have been garnished from commingled accounts—accounts containing both exempt benefits and other deposits.


36 Id. at 1.

37 Id. at 9.
No estimate was offered of what portion of the actual amount taken from these accounts represented exempt benefit funds. The remaining $6.3 million in garnishments were estimated to come from accounts containing solely directly deposited Social Security benefits. Thirty-seven percent of the financial institutions studied had garnished accounts that contained only Social Security Act benefit deposits, revealing that the problem was not confined to a small subset of banks.

In recent years, technological changes have markedly transformed the debt collection process. Amid the foreclosure crisis and troubling financial times, debt collection has become a "growth industry." At the same time, the market for purchasing difficult-to-collect consumer debts from creditors has grown. Debt buyers and collection firms, often far removed from the original creditor, flood courts with collection actions. According to a recent study on consumer credit in New York City, the 320,000 consumer debt cases filed in New York City Civil Court in 2006 exceeded all the Civil Court filings in 2001 by sixty percent. As bank regulators have acknowledged, these filings often contain incorrect information, leading to a lack of notice

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38 Id. In the sample, approximately forty-four percent of the money garnished from accounts that received only direct deposit Social Security benefits was garnished for an Internal Revenue tax levy, alimony, or child support, all of which are valid exceptions to the exemption provisions. See id.

39 Id. at 6.


41 Id. at 13; see also Tom Fredrickson, Thriving on Debtors' Woes; Collection Firms Expand in New York as Foreclosures Mean Other Debts Go Unpaid, CRAIN'S N.Y. BUS., Oct. 22, 2007, at 3 (describing the doubling, in prior two years, of firms in New York City licensed to collect debts). A partner at one law firm that does a substantial amount of collections work attributed the industry's growth "primarily to better technological tools with which to pursue debtors, which is enabling creditors to go after older and older debt." Id.

42 See Hunt, supra note 40, at 14.

and frequent default judgments against alleged debtors.\textsuperscript{44} Technology has also made it easier for creditors to file a garnishment order. In New York, creditors with a court judgment against a debtor benefit from laws allowing electronic service of restraint notices, enabling them to simultaneously serve several banks in hopes of finding an account in the judgment debtor's name.\textsuperscript{45}

Garnishment procedures differ by state. In New York and Minnesota, attorneys for a judgment creditor may issue a restraining notice themselves—without going to court.\textsuperscript{46} In most

\textsuperscript{44} Frozen Out, supra note 11, at 4 (Testimony of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency), available at http://finance.senate.gov/hearings/testimony/2007test/092007testms.pdf. Eighty percent of the cases reviewed in the New York City study involved default judgments. CMTY. DEV. PROJECT, supra note 43, at 1–2 (noting that one hundred percent of the applications for default judgment reviewed in the study were approved). A report based on data from New York City civil court cases concluded that "nine out of ten New Yorkers who are sued in the Civil Court of the City of New York are being denied their right to be heard because of possibly illegal process serving practices." CONSUMER RIGHTS PROJECT, MFY LEGAL SERVS., INC., JUSTICE DISSERVED 2 (2008), available at http://www.mfy.org/news/reports/Justice_Disserved.pdf; see also Jonathan D. Glater, Cuomo Tries To Enforce Notification to Debtors, N.Y. TIMES, Apr. 14, 2009, at B1 (discussing ongoing investigation of companies that fail to notify defendants of collection proceedings).

\textsuperscript{45} See N.Y. C.P.L.R. 5222(a) (McKinney 2009) ("[A restraining notice] shall be served personally in the same manner as a summons or by registered or certified mail, return receipt requested or if issued by the support collection unit, by regular mail, or by electronic means . . . ."); see also OFFICE OF FIN. EMPOWERMENT, supra note 5, at 2. In Minnesota, a creditor need not go to court but may independently issue a garnishment summons in certain instances. MINN. STAT. ANN. § 571.71 (West 2009); see also Randy Furst & Kara McGuire, State Laws Give Edge to Debt Collectors, STAR TRIB. (Minneapolis, Minn.), Aug. 24, 2008, at 1A, available at http://www.startribune.com/business/27314379.html?page=1&c=y (describing Minnesota as "one of few states where a bill collector can both file a lawsuit and garnish a debtor's bank account without appearing in court").

\textsuperscript{46} N.Y. C.P.L.R. 5222(a) ("A restraining notice may be issued by the clerk of the court or the attorney for the judgment creditor as officer of the court, or by the support collection unit designated by the appropriate social services district.") (emphasis added); MINN. STAT. ANN. § 571.71 (providing that, in certain circumstances, a creditor need not go to court but may independently issue a garnishment summons); see also Furst & McGuire, supra note 45. A recent amendment to the Minnesota statute severely restricts this provision. It allows for independent issuance of a garnishment summons only when a Notice of Intent to Garnish form and an exemption claim form are served upon a debtor twenty or more days after the summons and complaint are served. Moreover, the creditor must not receive an answer from the debtor within twenty-five days of service of the Notice. Act of May 1, 2009, ch. 31, § 4, 2009 Minn. Sess. Law Serv. 29–30 (West) (codified as amended at MINN. STAT § 571.71 (2008)). This legislation also outlines in detail the process through which an account holder can challenge a garnishment and assert an
states creditors must, after receiving a court judgment, return to court to obtain a garnishment order. When they receive a garnishment order, banks typically freeze the judgment debtor's account so that the funds cannot be withdrawn. Funds remain frozen until they are transferred to the judgment creditor—to satisfy the judgment—or the garnishment order is vacated. State garnishment statutes also normally provide a procedure through which an account holder can file a claim of exemption and thereby challenge some or all of the garnishment.

exemption and the respective duties of debtors, creditors, and financial institutions in resolving conflicting claims. Id. at 2, 6–7, 11–12 (codified as amended at MINN. STAT § 570.143 (2008)).

See, e.g., IND. CODE § 34-25-3-2 (2009) (requiring plaintiff to file affidavit with court to obtain a summons against a garnishee for property of a defendant); MISS. CODE ANN. § 11-35-1 (2009) (requiring plaintiff to apply in writing for a writ of garnishment to be issued by clerk of the court); OKLA. STAT. tit. 12, § 1173.4 (2004); N.D. CENT. CODE § 32-09.1-02 (2009) (allows creditor “to proceed by garnishment in any court having jurisdiction of the subject of the action”); accord S.D. CODIFIED LAWS § 21-18-1 (2009); UTAH R. CIV. P. 64D(c) (discussing requirements of application for post-judgment writ of garnishment).

See, e.g., Frozen Out, supra note 11, at 3–4 (testimony of Margot Saunders, Counsel, National Consumer Law Center); id. at 4–5 (testimony of Johnson Tyler, SSI Unit Director, South Brooklyn Legal Services) (discussing, from perspective of a legal aid attorney, the challenges encountered in assisting a client who receives exempt benefits and is attempting to get a restraint lifted); Schultz, supra note 9.

When banks receive a garnishment order, their standard response is to freeze the customer's account. Banks say it's not their job to check whether accounts contain cash from exempt sources. Collectors also don't treat it as their job. So the burden falls on Social Security recipients, typically elderly or disabled, who have suddenly lost access to their bank accounts and have no idea what to do.

Id.

For more on the state processes governing challenges to garnishment orders, see generally ROBERT J. HOBBS, FAIR DEBT COLLECTION § 12.3 (5th ed. 2004) (discussing “Due Process Protections from Garnishment or Execution of Exempt Property” and offering extensive digest of relevant case law).

See, e.g., ARIZ. REV. STAT. ANN. § 12-1580(A) (2009) (providing ten days for filing of claim of exemption and request for hearing); COLO. REV. STAT. § 13-54.5-108(1)(b)–(2) (2009) (giving debtor ten days to file a written claim of exemption with the court “setting forth with reasonable detail a description of the property claimed to be exempt, together with the grounds for such exemption” and providing for stay of execution until exemption claim is resolved); FLA. STAT. § 77.041 (2009) (providing text of “Notice to Defendant” to be served with garnishment order and including “Claim of Exemption and Request for Hearing” form that must be filed within twenty days).
Banks typically follow state garnishment procedures and restrain bank accounts because they fear liability for failing to do so.\footnote{See infra Part IV.E.1. Moreover, as noted supra at note 50, state statutes typically provide a procedure through which an account holder/benefit recipient can raise an exemption after her account is restrained.} These fears arise in part from the belief that federal exemption statutes do not clearly prohibit a temporary restraint or freeze, but instead, only forbid the permanent transfer of exempt funds from a beneficiary's account to a judgment debtor. Others, including bank regulators and even the Social Security Administration itself, have stated that the protections provided in § 407 do not represent an absolute bar to garnishment actions, but instead serve as an affirmative defense that must be raised by an account holder who wishes to benefit from the statute's protections.\footnote{See infra notes 137–140, 181–185 and accompanying text.} Finally, and most simply, banks contend that they must follow state garnishment procedures because they cannot, and it is not their role to, determine whether the funds in an account are exempt.\footnote{See infra notes 146–148 and accompanying text.} Banks argue that making such a determination is particularly difficult in the context of commingled accounts, which contain both exempt benefit funds and funds from some other nonexempt source.\footnote{See, e.g., infra note 97 and accompanying text.} Despite these protestations, however, a number of banks do examine their customers' accounts and refuse to freeze accounts that clearly contain exempt benefits.\footnote{See infra notes 149–152 and accompanying text.} This review process can be rendered increasingly easy when benefits are deposited electronically through direct deposit.

B. The Peril and Promise of Direct Deposit

In the past decade, increasing numbers of Social Security, Social Security Disability (“SSD”), and SSI beneficiaries have begun receiving their benefits through direct electronic deposit. Federal policy encourages benefit recipients to utilize direct deposit.\footnote{See 31 C.F.R. § 208.3 (2009) (requiring use of electronic funds transfer for payments made by all federal agencies); id. § 208.4 (providing for waivers to payment by electronic funds transfer).} As of December 2008, over eighty percent of
beneficiaries receive their benefits electronically. The Social Security Administration “strongly encourages all Social Security and SSI beneficiaries to receive their monthly benefits by direct deposit.” This strong preference reflects a broader federal effort to promote direct electronic deposit. The active marketing and promotion of electronic payments (and of direct deposit of benefit payments in particular) is an important component of the Treasury Department’s efforts to reduce the costs of issuing payments.

According to a study sponsored by the Treasury Department, transitioning the remaining approximately twenty percent of benefit recipients who receive paper checks to electronic payments could save more than $100 million annually. It currently costs the Treasury Department approximately ninety-eight cents to issue a paper check but only ten cents to issue an electronic payment, for a savings of eighty-eight cents per payment distribution. Given that Treasury’s Financial Management Service (“FMS”) disburses approximately 568 million payments of Social Security and SSI alone each year, the use of electronic deposit, if made universal, would represent a savings of roughly $500 million each year from the cost of distributing these benefits in paper form.

Although it clearly saves the federal government significant amounts of money, for benefit recipients direct deposit remains both a blessing and a curse. It allows individuals to obtain quicker access to their funds, encourages the utilization of banking services, and enables beneficiaries to avoid check-

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59 OFFICE OF THE INSPECTOR GEN., supra note 35, at 1–2.
62 Protecting Social Security Benefits, supra note 18 (testimony of Gary Grippo, Deputy Assistant Sec’y for Fiscal Operations, Dep’t of the Treasury).
63 See id.
cashing fees. At the same time, direct deposit renders a recipient’s money, once it is deposited in a bank account, more readily accessible to judgment creditors and their lawyers.\(^6\) Debt collectors are now able to electronically serve a large number of national banks in hopes of finding an account in the debtor’s name at any one of those banks: “Frequently, these demands are mass mailed to banks in circumstances in which the debt collector may not have any reason to believe that a debtor has an account at the institution, or that any such account contains funds that lawfully may be attached.”\(^6\) In some states, a writ of garnishment, once served, is continuing, requiring the garnishee-bank to attach not only the money in an account at the time the writ of garnishment is served, but also any money that comes into the account in the future—until the full judgment amount is taken from the garnishee or a court terminates the garnishment order.\(^6\) In some situations, when an account is frozen for a number of weeks or longer, a subsequent check will

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\(^{65}\) See Schultz, supra note 9 (describing how direct deposit has created “an infrastructure that makes it cheaper and easier for collectors to pursue elderly or disabled subjects of old debts”).

\(^{66}\) Frozen Out, supra note 11 (Testimony of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Comptroller of the Currency). New York State law is particularly friendly to creditors, requiring minimal effort to restrain an account. See Johnson M. Tyler, Exempt Income Protection Act Better Protects Strapped Debtors, N.Y. L.J., Jan. 27, 2009, at 4 (“[L]ocating and freezing the bank account of a New York debtor is now as simple (and cheap) as clicking a mouse.”). Article 52 of the New York Civil Practice Law and Rules governs garnishment and permits a creditor to enforce a money judgment by serving a third party, such as a bank, which controls the assets of the debtor, with a restraining notice. Mayers v. N.Y. Cmty. Bancorp, Inc., No. CV-03-5837 (CPS), 2005 WL 2105810, at *1 (E.D.N.Y. Aug. 31, 2005). The creditor’s attorney, acting as an “officer of the court,” is able to sign this restraining notice. This notice can be served by a variety of means, including e-mail, when a bank consents to such service. This allows creditors and their attorneys to quickly serve restraining notices on a range of banks, at times fishing for debtors’ accounts. Id.; see also Lucette Lagnado, Cold-Case Files: Dunned for Old Bills, Poor Find Some Hospitals Never Forget, WALL ST. J., June 8, 2004, at A1 (quoting collection firm representative who described process of serving multiple banks as “basically a blitz—you blitz all the banks”).

\(^{67}\) See, e.g., 42 PA. CONS. STAT. ANN. § 3111 (West 2009) (“Service of the Writ on Garnishee. Effect”); see also Comment from Andrea Beggs, Senior Vice President, Legal & Compliance Dep’t, JP Morgan Chase, to Fed. Fin. Regulatory Agencies, Regarding Notice of Proposed Guidance on Garnishment of Exempt Fed. Benefit Funds, 8 (Nov. 27, 2007), available at http://www.federalreserve.gov/SECRS/2007/ November/20071129/OP-1294/OP-1294_14_1.pdf (“We note that some state orders (such as a Restraining Notice in New York and a Citation to Discover Assets in Illinois) require a bank to hold all future deposits in an account for a period of time, or sometimes indefinitely.”).
arrive in the account during the freeze, becoming inaccessible to the recipient. Paper checks can allow a recipient to avoid this danger by choosing not to deposit a newly arrived check into a frozen account.

Although it poses dangers, direct deposit also can prove helpful to debtors, as these deposits—which are electronically coded—render the source of a bank deposit more readily identifiable. This can be especially important in the context of commingled accounts. A commingled bank account contains both exempt benefits and funds from some other, nonexempt source. Such accounts have been a particular concern for banks, which frequently contend that commingling renders it impossible to distinguish between exempt and nonexempt funds in an account. Advocates for benefit recipients reject this claim and argue that, given the electronic coding of deposits, it would require minimal effort for banks to determine whether the funds in an account are exempt and, if so, to refuse to freeze an account. As a federal district court in New York observed, this potential for easier identification of electronic funds, combined with the increased ease with which creditors can serve banks and freeze assets, may demand a reevaluation of whether current state garnishment procedures adequately protect the due process rights of benefit recipients. At the same time, members of Congress, recognizing

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68 Baribeau, supra note 64, at 13 ("[P]eople who get Social Security payments by direct deposit stand to lose access to more money, for longer, than those who get a paper check. Two Social Security payments may be deposited into a frozen account before an account holder can switch to a paper check.").

69 Mayers, 2005 WL 2105810, at *13. In Mayers, the plaintiffs, who challenged the former New York garnishment statute (changed in January 2009 by New York’s Exempt Income Protection Act), contended that “changes in technology which have enabled the electronic transfer of funds allow banks ‘to quickly and easily determine if an account contains only exempt money prior to restraining it.’” Id. at *12 (citation omitted). The plaintiffs argued that these technological changes called for a reevaluation of the procedures necessary to protect a benefit recipient’s due process rights. Id. In determining the proper procedures, a court must balance the factors articulated in the Supreme Court’s decision in Matthews v. Eldridge, 424 U.S. 319 (1976), which outlines the balancing test courts must apply when government action might result in the deprivation of an individual’s property interest. According to Matthews:

[Resolution of . . . whether . . . procedures provided . . . are constitutionally sufficient requires analysis of the governmental and private interests that are affected. More precisely, our prior decisions indicate that identification of the specific dictates of due process generally requires consideration of three distinct factors: First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest


the substantial efforts underway to encourage direct deposit, have begun to question whether the government should continue to encourage electronic deposit given the dangers faced by account holders. Senator Herb Kohl, Chair of the Senate Special Committee on Aging, introduced a bill, in April of 2008 and again in May of 2009, which would prohibit the use of Treasury Department and Social Security Administration funds to promote the direct deposit of benefits until provisions are in place to adequately protect funds from attachment and garnishment. As this Article neared publication, the Department of the Treasury and other federal agencies were preparing to release for comment proposed joint regulations designed to prevent the garnishment of federal benefits.

through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

Id. at 334–35 (citations omitted). The Mayers plaintiffs argued that electronic deposits now enable banks to easily determine the status of funds in an account without notifying the debtor, who, if given notice, might try to conceal the assets. Mayers, 2005 WL 2105810, at *12. The plaintiffs, therefore, claimed that the case could be distinguished from an earlier Second Circuit case, McCahey v. L.P. Investors, 774 F.2d 543 (2d Cir. 1985). Mayers, 2005 WL 2105810, at *12. McCahey held that New York's garnishment statute struck a fair balance between the competing interests of creditors, debtors, and the state, and therefore, satisfied the demands of due process. 774 F.2d at 549. The Mayers plaintiffs claimed that McCahey could be distinguished on the grounds that, prior to electronic deposit, only a debtor could determine whether the funds in her account were exempt. Mayers, 2005 WL 2105810, at *12. Hence, the creditor's interests were endangered by the possibility that preseizure notice to the debtor would result in the assets being concealed. Id. The judge in Mayers decided that plaintiffs had alleged facts not considered in McCahey and called for a reconsideration of the second and third prongs of the Matthews test. Id. at *13. Accordingly, he rejected the defendants' motion to dismiss plaintiffs' due process claims. Id. at *14.

The Mayers Court noted its disagreement with the decision of another judge in the Eastern District of New York. Id. at *13. In Huggins v. Pataki, No. 01-CV-3016 (JG), 2002 WL 1732804 (E.D.N.Y. July 11, 2002), the court rejected a similar argument that technological changes in the years since McCahey rendered that case distinguishable and demanded a new analysis of the due process concerns. Id. at *4. The Huggins Court held that its decision was dictated by the Second Circuit's holding in McCahey. Id.


71 See S. REP. NO. 111-43, at 13 (2009) (expressing Committee on Appropriation's concern regarding freezing and garnishment of federal benefits and
The lack of such protections can diminish consumer trust in banks and cause benefit recipients to stop utilizing direct deposit.\textsuperscript{72} This is a particular concern given that efforts to encourage direct deposit, as well as seeking to reduce government costs, strive to encourage benefit recipients to access banking services. As an FDIC representative testified during a Senate hearing regarding the garnishment of exempt benefits:

The adverse publicity and concerns about garnishment can undercut the attractiveness of an insured bank as a place for people to utilize financial services, such as checking, savings and direct deposit. The resolution of this issue is important to the achievement of our broader efforts to encourage consumers to be economically empowered through the banking system.\textsuperscript{73}

Hence, a solution to the problem of garnishment can—in addition to furthering Congress's intended goal in creating these exemptions to protect individual benefit recipients—also advance efforts to encourage direct deposits and broaden the utilization of financial services. Ensuring the security of exempt benefits that are deposited into bank accounts can also further the broader goals of social insurance, including the desire to provide workers with a “degree of security” that will encourage them to take the risks needed for a competitive economy to thrive.\textsuperscript{74} Given the amount of money at stake, in terms of both government savings from electronic deposit and actual federal benefit payments, as well as the range of federal policy goals affected, there is a

\textsuperscript{72} See OFFICE OF FIN. EMPOWERMENT, supra note 5, at 3–4 (describing how the fear of bank freezes drives some federal benefit recipients to avoid bank accounts and instead utilize costly check cashing services); Schultz, supra note 27 (referencing legal aid lawyers who claim that Social Security recipients are opting out of direct deposit to protect their benefits from banks).

\textsuperscript{73} Frozen Out, supra note 11, at 12 (testimony of Sara A. Kelsey, General Counsel, FDIC).

\textsuperscript{74} See E.J. Dionne, Jr., Why Social Insurance?, SOCIAL SECURITY BRIEF, No. 6, at 2 (1999), available at http://www.nasi.org/usr_doc/ss_brief_6.pdf (describing "risks that we now have forms of social insurance for" including "industrial accidents, illness, premature death, unemployment [and] old age"); see also Jacob S. Hacker, Sharing Risks in a New Era of Responsibility, Health and Income Security Brief, No. 13, at 5, (2009) available at http://www.nasi.org/usr_doc/Sharing_Risks_in_a_New_Era_of_Responsibility.pdf ("In a dynamic and flexible economy, well designed social insurance is critical if Americans are going to have the confidence that they need to invest in and achieve the American dream.").
pressing need to craft an adequate federal response to this issue. The state efforts discussed in the next Part of this Article offer important insights for crafting a federal policy.

II. STATE SOLUTIONS TO THE GARNISHMENT PROBLEM FAIL TO ENSURE CONSISTENT TREATMENT OF FEDERAL BENEFITS BUT PROVIDE MODELS FOR A FEDERAL RESPONSE

A. Administrative Changes in the States, and the Opposition They Have Encountered

A number of states have sought to provide stronger protections—from freezes, attachment, and garnishment—for exempt federal benefits. While nearly all states offer some procedure through which an account holder, after her account is frozen, may assert an exemption and challenge the attachment or garnishment of her funds, certain states have decided that these procedures alone provide insufficient due process protections, are in tension with federal law, or fail to prevent substantial hardships for benefit recipients during the period of an account freeze. A few states, as outlined in this Section, have altered their procedural rules and garnishment forms to remedy these perceived deficiencies.

1. Pennsylvania

In 2007, the Pennsylvania Supreme Court approved an amendment to the state's civil procedure rules. The amendment states that a garnishment writ served upon a financial institution

shall not attach any of the defendant's funds on deposit with the bank or other financial institution in an account in    

which . . . funds are deposited electronically on a recurring basis

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75 See supra notes 49–50.
76 See infra note 87 and accompanying text.
and are identified as being funds that upon deposit are exempt from execution, levy or attachment under Pennsylvania or federal law.\textsuperscript{78}

As Pennsylvania's Civil Procedure Rules Committee has confirmed, this rule protects "all funds in an account in which any [exempt] funds are deposited electronically on a recurring basis."\textsuperscript{79} In 2008, the Rules Committee proposed an additional amendment to this provision, which would protect from attachment only the first $10,000 in a commingled account into which exempt funds are electronically deposited on a recurring basis.\textsuperscript{80} Under the recently proposed amendment, if the account holder believes that additional funds are in fact exempt, he or she may then assert this exemption.\textsuperscript{81} In addition, if all funds in the account are electronically deposited exempt income, the garnishment order shall not attach any of the money in the account.\textsuperscript{82}

The 2007 amendment also altered Pennsylvania's Writ of Execution form and the rules governing the interrogatories that a garnishee financial institution must answer when it receives an order to attach funds in a bank account.\textsuperscript{83} The revised "Interrogatories to Garnishee" include two new questions specifically directed towards financial institutions.\textsuperscript{84} These interrogatories make the bank responsible for determining whether an account contains identifiable exempt funds deposited electronically on a recurring basis.\textsuperscript{85} If so, the bank must

\textsuperscript{78} 42 PA. CONS. STAT. ANN. § 3111.1 (West 2009) (effective Apr. 7, 2007).
\textsuperscript{79} 42 PA. CONS. STAT. ANN. § 3111.1 (West 2009) (explanatory comment).
\textsuperscript{80} Id. at 7.
\textsuperscript{81} Id.
\textsuperscript{82} Id.
\textsuperscript{83} Id. (Interrogatory No. 7) ("If you are a bank or other financial institution, at the time you were served or at any subsequent time did the defendant have funds on deposit in an account in which funds are deposited electronically on a recurring
determine what exemptions apply, the amount of funds they apply to, and the entity that electronically deposits the funds. This information must then be included in the answers that the garnishee-bank is required to file within twenty days of being served with the interrogatories.\footnote{At least one source has claimed anecdotally that banks are finding this provision difficult to comply with. In a Letter from D. Robert Enten, on behalf of the Md. Bankers Ass'n, to Honorable Joseph F. Murphy, Jr., Chairperson, Standing Comm. on Rules of Practice and Procedure (June 18, 2007), the author asserts that "[feedback from counsel to the Pennsylvania Bankers Association is that their members are finding it impossible to comply [with the 2007 rule]."}

The 2007 explanatory comment to Pennsylvania's amended rule explicitly states that prior to that amendment, the Pennsylvania rules of civil procedure failed to comply with the requirements of federal law in 42 U.S.C. § 407.\footnote{42 PA. CONS. STAT. ANN. § 3111.1 (explanatory comment).} The Pennsylvania amendment seeks to remedy this by requiring banks to determine whether the funds in an account represent exempt benefits and to refuse to freeze such funds. As the explanatory comment notes, the defendant benefit recipient no longer must claim the exemption: Instead "the judgment creditor rather than the defendant has the burden of raising an issue with respect to exempt payments . . . [t]he defendant need not file a claim for exemption as exempt funds are not attached."\footnote{Id. Pennsylvania’s provision does not specify an accounting method to be used in distinguishing between exempt and nonexempt funds should there be funds in the account in excess of $10,000.}

2. Alabama and Michigan

In 2006, Alabama state courts issued new garnishment forms that inform the garnishee (which would include a bank) that:

Social Security, SSI, VA and federal retirement moneys are all exempt under federal law and remain so even when deposited in a bank or other financial institution. If the only money in your possession or control belonging to the defendant is Social
Security, SSI, VA or federal retirement moneys, you should indicate in your answer "all such money is exempt from execution." This system, like that in Pennsylvania, requires banks, as garnishees, to examine an account to determine whether it contains exempt funds. However, in contrast with the Pennsylvania protections, in Alabama, the garnishment form indicates that a garnishee bank is required to refuse an execution order only when "the only money" in its possession is exempt. Hence, while the Pennsylvania provision would protect exempt money held in an account containing commingled funds, the Alabama system only protects exempt funds that are not commingled in a bank account with other, nonexempt funds.

On May 19, 2009, the Michigan Supreme Court issued an order adopting an amendment to Rule 3.101 of the Michigan Court Rules, “Garnishment After Judgment.” The amendment contains language similar to that found on the Alabama garnishment forms, limiting its protections to accounts that contain only exempt funds. The new language for Rule 3.101(I)(6) states that:

A bank or other financial institution, as garnishee, shall not withhold exempt funds of the debtor from an account into which only exempt funds are directly deposited and where such funds are clearly identifiable upon deposit as exempt Social Security benefits, Supplemental Security Income benefits, Railroad Retirement benefits, Black Lung benefits, or Veterans Assistance benefits.

A garnishee financial institution, according to the Rule, is also required to send, with fourteen days of being served with the writ of garnishment, a verified disclosure to the court, the plaintiff,

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91 Id.
and the defendant. If the financial institution is claiming that the funds are exempt, it must indicate the specific exemption on this disclosure form.\textsuperscript{92}

3. Maryland and Virginia

Other states have also attempted, through changes in state civil procedure rules and court forms, to require banks to examine accounts and refuse to attach exempt funds. These efforts, in states including Maryland and Virginia, have faced substantial opposition from state banking associations and have either failed or, in the case of Virginia, briefly succeeded before quickly being reversed. They offer a cautionary tale with regards to attempts to provide protections through the judiciary and on a state-by-state basis.

In 2004, the Virginia Supreme Court amended Virginia's garnishment forms.\textsuperscript{93} The changed forms required banks to determine whether an account contained exempt funds and, if it contained only direct deposit exempt funds, to refuse to honor a garnishment order.\textsuperscript{94} After one bank was sued by an account holder for failing to identify exempt funds and refuse a garnishment order, the Virginia Bankers Association campaigned to reverse the amendment, contending in part that the change was not authorized by the relevant statute.\textsuperscript{95} In an August 2006 letter to the clerk of the Supreme Court of Virginia, the Association contended both that the change was not supported by the relevant statute and that it would "create significant new burdens and costs for our banks which we believe the Court may not have appreciated at the time the form changes were authorized."\textsuperscript{96} In particular, the Association claimed that the prevalence of commingled funds would render it "time-consuming and difficult to determine whether or not funds in an

\textsuperscript{92} Id. If the specific exemption is not among those listed in the rule, the garnishee financial institution must state the exemption and cite the legal authority for that exemption.

\textsuperscript{93} Kuehner-Hebert, \textit{supra} note 77, at 7.

\textsuperscript{94} Id.

\textsuperscript{95} Id.

account consist ‘solely’ of direct deposited federal benefits.”97 In addition to these administrative considerations, the Association expressed concern, exacerbated by its belief that the changed forms were not authorized by the statutory language, that judgment creditors would raise claims against banks, contesting whether the money in an account is actually exempt thus creating liability for the banks.98

The Supreme Court of Virginia responded to the Association’s efforts by revising the relevant forms and removing the requirements regarding federal exemptions from garnishment.99 In a letter to the Association confirming these changes, the Court’s Executive Secretary stated that the modifications were due to “an inconsistency between the garnishment summons and the [state] statutory form” and “the potential for misreading the statement as creating an obligation for banks that does not otherwise exist.”100

In October 2006, a similar amendment, which would have required banks to examine accounts for exempt funds, was proposed to the Maryland state courts’ Standing Committee on Rules of Practice and Procedure.101 The Maryland Banker’s Association (“MBA”) responded to the proposed amendment, echoing many of the concerns raised by the Virginia Bankers Association.102 In subsequent written comments, the MBA

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97 Letter from Joseph E. Spruill, III to Patricia L. Harrington, supra note 96.
98 Id.; Johnson & Reed, supra note 96.
99 See Baribeau, supra note 64 (“In 2004, Virginia courts were the first of a handful of state courts to amend restraining notices to prohibit banks from freezing accounts that contained only exempt funds. But after the [Association] met with court officials to argue that the change flouted Virginia law, the court reinstated the old forms.”).
100 Letter from the Office of the Executive Sec’y, Supreme Court of Va., to Joseph E. Spruill, III, Gen. Counsel, Va. Bankers Ass’n (Jan. 17, 2007).
101 Letter from Md. Legal Aid Bureau to Honorable Joseph F. Murphy, Jr., Chairperson, Standing Comm. on Rules of Practice & Procedure (Oct. 3, 2006).
102 Letter from D. Robert Enten, on behalf of the Md. Bankers Ass’n, to Sandra F. Haines, Standing Comm. on Rules of Practice & Procedure, Court of Appeals of Md. (Dec. 7, 2006). The Nebraska Bankers Association also raised similar arguments in successfully convincing the Nebraska Supreme Court to reject proposed changes to Nebraska’s uniform garnishment forms. See Letter from Gerald M. Stilmock, Assoc. Gen. Counsel, Neb. Bankers Ass’n, to Lanet Asmussen, Clerk, Supreme Court of Neb. (June 15, 2007).
questioned the judiciary’s power to require banks to assert an exemption on behalf of their depositors.\textsuperscript{103}

The Judgments Subcommittee of the Maryland Rules Committee then attempted to alleviate the additional concern that the proposed rule would impede the attachment of nonexempt funds. It altered the amendment’s language to confine its application to accounts that contained only exempt funds, a system akin to that in Alabama.\textsuperscript{104} Nonetheless, the full Rules Committee ultimately decided that the matter was beyond the scope of its authority and should be decided instead by the state’s legislature.\textsuperscript{105}

These experiences at the state level are informative. The state bankers associations in Virginia and Maryland voiced concerns that have been routinely expressed by banks and banking associations in their comments regarding the proposed federal agency guidance on the garnishment of exempt funds.\textsuperscript{106} While the provisions in Pennsylvania and Alabama provide some protection for exempt funds, the events in Virginia and Maryland indicate that a legislative response, rather than a change sought through the judiciary or an administrative agency, might provide the most effective solution.\textsuperscript{107} Four other states—California,
Connecticut, New York, and Oregon—have responded to the garnishment problem through legislation. This legislation, which creates an automatic exemption of a set amount of funds in accounts that receive exempt direct deposits, also may prove easier for banks to implement than a rule requiring them to determine the precise amount of funds in an account that represent exempt benefits.

B. Statutory Solutions in California, Connecticut, New York, and Oregon: Possible Models for Federal Action?

California, Connecticut, New York, and Oregon have each instituted laws to protect exempt benefits held in bank accounts. The California, Connecticut, and New York laws share a similar requirement that a bank, upon receiving a garnishment order, must review an account to determine if it receives directly deposited exempt funds and, if it does receive such funds, automatically leave a fixed amount of money in the account and then freeze or restrain only the funds that exceed this amount. Rather than protect a fixed amount, the Oregon law requires a bank to protect an amount equal to the sum of exempt funds directly deposited in the account during the calendar month preceding the service of a writ of garnishment. For the sake of

The proposed amendment to Rule 6:7-1 would require that any levy of an account pursuant to a writ of execution or other process to enforce a judgment must exclude “all funds deposited electronically in an account of the debtor with a bank or other financial institution during the 45 days immediately prior to service of the writ that are identifiable by the bank or other financial institution as exempt from execution, levy or attachment under New Jersey or federal law.” Id. at 10. In addition, if all deposits into the account for the 90 days immediately prior to service of a writ were “electronic deposits, made on a recurring basis” of fund identifiable to the bank as exempt, then all the funds in the account must be excluded from any levy. Id. The Committee recognized that there was a “danger of intruding on the legislative realm if it sought to create new substantive rights,” but it deemed it clear that the relevant rights were already recognized by state and federal law and the only question was how best to implement this legislation in the judicial context. Id. at 7. An additional proposed amendment would alter the form for a writ of execution, with the goal of ensuring that a garnishee bank knows that a levy should not include funds that the bank can identify as exempt. Id. at 11-12.

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clarity, these provisions, which do not require any action on the part of a benefit recipient to be effectuated, will be referred to collectively as “automatic exemptions.”

The first three states’ laws differ in their details, but each protects a set amount of funds in any bank account into which exempt benefits are electronically deposited. Under the Connecticut statute, a financial institution served with a garnishment order must leave the lesser of the account balance or $1,000 in any account into which “electronic direct deposits that are readily identifiable as exempt” have been deposited during the prior thirty-day period. The New York’s law protects the first $2,500 in a judgment debtor’s account into which “direct deposit or electronic payments reasonably identifiable as statutorily exempt payments were made” during the prior forty-five days.

The California provision, which has been in effect since the early 1980s, provides similar protections to any account into which Social Security benefits or public benefits are directly deposited. These accounts are exempt, without the account holder claiming an exemption, in varying amounts depending on whether the depositor receives public benefits or Social Security and whether one, two, or more depositors are the designated recipients of the benefits payments. Currently, an account in which “one depositor is [the] designated payee” of Social Security benefits is automatically exempt in the amount of $2,700.

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109 CONN. GEN. STAT. § 52-367b(c) (2008).
111 See CAL. CIV. PROF. CODE § 704.080 (West 2009) (noting in Credit(s) that provision took effect on July 1, 1983).
112 Id. The amount of money protected is adjusted every three years by the Judicial Council based on changes in the California Consumer Price Index. Id. § 703.150.
California courts, in applying the state's statutory exemptions, have stated that “[t]he exemption laws are designed to facilitate the debtor's financial rehabilitation and have the effect of shifting social welfare costs from the community to judgment creditors.”

In Oregon, a bank, upon receiving a writ of garnishment, must determine whether one or more of a set of statutorily enumerated benefit payments "were deposited in the account by direct deposit or electronic payment during the calendar month that preceded the month in which the writ of garnishment is delivered to the financial institution." If so, the bank must refuse to garnish "an amount equal to the lesser of the sum of those payments or the total balance in the debtor's account." The Oregon bill expressly provides that either the exempt amount must be readily identifiable to the bank from information the payor transmitted to the bank with the payment or the benefit recipient must notify the bank, through a written affidavit, that the account receives exempt benefits.

Each of these state systems provides a procedure through which an account holder may assert an exemption from garnishment for any funds in the account that exceed the automatic exemption. This ensures that benefit recipients retain control of some amount of their funds while they raise a challenge to the garnishment of any exempt funds among the remaining money in their accounts. This protection not only enables benefit recipients to continue paying for rent, food, medical expenses, and other necessities, but also provides recipients with access to funds that may be needed to obtain legal counsel or otherwise assert additional exemptions and challenge the garnishment order.

These provisions in California, Connecticut, and New York also attempt to clarify and expedite the court procedures for judicial determinations of whether additional funds are

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116 Id.
117 Id. at § 2(3) & 4(c).
118 CAL. CIV. PROC. CODE § 704.080(d)–(f); CONN. GEN. STAT. § 52-367b(f) (2008); N.Y. C.P.L.R. 5222-a (McKinney 2009); OR. S.B.732 § 2(6).
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exempt.\textsuperscript{119} The New York law seeks, when possible, to have the matter resolved by the judgment debtor, the judgment creditor, and the bank without requiring a court hearing.\textsuperscript{120} If the judgment debtor claims that additional funds are exempt, and the judgment creditor does not object—through an affidavit that demonstrates a reasonable belief that the account contains nonexempt funds—the bank must release the remaining funds to the judgment debtor within eight days after the exemption claim form is postmarked.\textsuperscript{121} At the same time, the creditor is instructed, upon receiving the exemption claim form, to direct the banking institution to release the account.\textsuperscript{122} However, if the account contains commingled funds, the creditor is required to determine the status of the funds by applying the lowest intermediate balance method of accounting and then instruct the banking institution to release the exempt funds in the account.\textsuperscript{123} If the creditor objects to a claim of exemption, the bill delineates an expedited procedure through which the court will determine whether funds are exempt.\textsuperscript{124} It also provides additional protections for a judgment debtor, enabling her to counterclaim against a judgment creditor if the creditor's objection is raised in bad faith or the creditor possesses actual knowledge that the funds in question are exempt.\textsuperscript{125} The Association of the Bar of the City of New York has predicted that these new procedures for resolving exemption questions will mean "that most disputes will end without resort to an already overburdened court system."\textsuperscript{126}

\textsuperscript{119} CAL. CIV. PROC. CODE § 704.080(d)–(f); CONN. GEN. STAT. § 52-367b(f); N.Y. C.P.L.R. 5222-a.
\textsuperscript{120} See N.Y. C.P.L.R. 5222-a.
\textsuperscript{121} Id. 5222-a(c)(3). The law outlines some of the documents that can establish the exempt status of funds. Id. 5222-a(c)(4) ("Information demonstrating that funds are exempt includes, but is not limited to, originals or copies of benefit award letters, checks, check stubs or any other document that discloses the source of the judgment debtor's income, and bank records showing the last two months of account activity.").
\textsuperscript{122} Id. 5222-a(c)(4). The creditor can face penalties for failing to follow the law. Id. ("If the judgment creditor fails to act in accordance with this subdivision, the judgment creditor shall be deemed to have acted in bad faith and the judgment debtor may seek a court award of the damages, costs, fees and penalties provided for in subdivision (g) of this section.").
\textsuperscript{123} Id.; see infra note 206 and accompanying text (explaining lowest intermediate balance method of accounting).
\textsuperscript{124} See N.Y. C.P.L.R. 5222-a(d).
\textsuperscript{125} Id. 5222-a(g).
\textsuperscript{126} CONSUMER AFFAIRS COMM., ASS'N OF THE BAR OF THE CITY OF N.Y., COMMENTS CONCERNING EXEMPT INCOME PROTECTION ACT 1–3 (2008), available at
The New York law garnered support from banking associations and groups representing debt collectors. The New York Bankers Association withdrew its initial opposition to the law after changes were put in place limiting the number of freezes a creditor can request—to two per account per year—and specifying that banks are responsible only for protecting accounts that receive "reasonably identifiable" direct deposits of exempt funds.

As is discussed in greater detail below, a federal policy should not outline a specific procedure for resolving exemption claims in relation to additional funds; this remains a proper object of state law and judicial rulemaking. Nonetheless, in creating an automatic exemption, Congress should consider the procedures states might apply in adjudicating additional exemption claims. These procedures will affect how long an individual might lack access to those funds that exceed the

http://www.nycbar.org/pdf/report/Comments%20Bk%20Restraint%20Legis%2020Jan%20008.pdf. As the New York Bar Association's comments note:

The legislation also adopts a simplified, streamlined approach for resolving questions as to whether funds in an account are exempt. Briefly stated, a creditor will be required, upon serving a bank with a restraining notice, to provide the bank with an exemption claim form which the bank then sends to the debtor. If the debtor desires to claim more than $2500 in direct deposit statutorily exempt funds, or more than $1716 in exempt wages, he or she may do so by returning the claim form and any appropriate supporting documentation. If the creditor then wants to dispute the debtor's claim, it may do so via an expedited court proceeding.

Id. Similar concerns regarding "the efficient use of judicial resources" represent a central factor courts have considered in evaluating how well a state's debt collection procedures protect a debtor's due process rights. See, e.g., McCahey v. L.P. Investors, 774 F.2d 543, 549 (2d Cir. 1985).

Maria Aspan, Regulator Project Seeks Garnishment Consistency, AM. BANKER, July 10, 2008, at 1 (discussing support for New York bill on the part of State Bankers Association and debt collectors, who concluded that it reasonably balanced the interests of creditors, debt collectors, and recipients of exempt benefits).

Id.; see also Editorial, Cushion for Debtors, NEWSDAY, Dec. 2, 2008, at A32 (discussing how New York State Bankers Association worked with New Yorkers for Responsible Lending to pass law).

The Federal Rule of Civil Procedure governing execution of a money judgment states that "[t]he procedure on execution—and in proceedings supplementary to and in aid of judgment or execution—must accord with the procedure of the state where the court is located, but a federal statute governs to the extent it applies." FED. R. CIV. P. 69.
automatic exemption amount while they assert any additional exemption claim. The particulars of the California, Connecticut, and New York laws are presented in more detail in the Appendix.

III. FEDERAL RESPONSES AND THE NEED FOR CONGRESSIONAL ACTION

Members of Congress have expressed their interest in strengthening protections from garnishment for exempt federal benefits. They have voiced frustration with the hesitation of federal benefit and financial regulatory agencies to craft a sufficient response. The financial regulatory agencies promulgated a proposed guidance, discussed infra, to guide banks in responding to garnishment orders. Unfortunately, this guidance fails to provide adequate protections that reinforce the congressional intent behind 42 U.S.C. § 407. The comments offered in response to the guidance, however, do provide significant insights into the concerns of various stakeholders. As such they provide valuable information for developing a politically and practically feasible federal policy.

A. Section 207 of the Social Security Act: A Bar Prohibiting Garnishment Actions or Merely a Defense for Debtors Who Know About It?

In September 2007, the Senate Finance Committee held a hearing entitled “Frozen Out: A Review of Bank Treatment of Social Security Benefits.” The hearing occurred on the day after federal banking regulators had issued a proposed guidance for banks regarding how they should respond to state court orders to freeze accounts that contain exempt federal benefits. Finance Committee Chairman Baucus expressed his disappointment with the proposed guidance, contending that it failed to adequately acknowledge the supremacy of federal law

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130 See supra notes 20, 70 and accompanying text.
131 See infra note 135 and accompanying text.
132 See infra Part III.B.
over state court procedure. He also strongly asserted that federal law bans the garnishment or freeze of Social Security and other protected funds. The federal regulatory agencies, particularly the Federal Deposit Insurance Corporation ("FDIC"), challenged this position in their written statements and oral testimony. It contended that, rather than bar the freezing and garnishment of benefits, the exemption provision in section 207 of the Social Security Act merely provides an affirmative defense, which a judgment debtor may raise in the process of responding to a garnishment order. The FDIC and the Office of the Comptroller of the Currency both testified that the Social Security and Veterans Administration had each interpreted the garnishment exemptions in their governing statutes as an affirmative defense to be raised after a freeze, rather than a bar prohibiting the initial imposition of a freeze or hold. Voicing a similar sentiment, the Office of Thrift Supervision, in its own testimony, argued that "[f]ederal laws that protect federal benefits [from garnishment] do not specifically prohibit a financial institution from freezing an individual's account during

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135 Frozen Out, supra note 11 (statement of Senator Max Baucus); see also Cheyenne Hopkins, Senator Baucus Calls for Clearer Garnishment Ban, AM. BANKER, Sept. 21, 2007, at 3.
136 Frozen Out, supra note 11 (statement of Senator Max Baucus); see also Hopkins, supra note 136.
137 Frozen Out, supra note 11, at 4 (testimony of Sara A. Kelsey, General Counsel, FDIC).
138 Id.
139 Id.; Frozen Out, supra note 11, at 6 (testimony of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Comptroller of the Currency). The Comptroller of the Currency’s representative further testified:
To our knowledge, the Social Security Administration has not spoken to this point [how depository institutions should respond to court-issued garnishment orders directing them to freeze an account] and its internal Program Operations Manual System ("POMS") provides that the "responsibility [of the Social Security Administration] for protecting benefits against legal process and assignment ends when the beneficiary is paid" and "if a beneficiary is ordered to pay his/her benefits to someone else, or his/her benefits are taken by legal process, he/she can use [section 207] as a personal defense against such actions." Our informal consultations with legal staff of the Social Security Administration have been consistent with the view that section 207 is a defense available to be asserted by the customer defense [sic] against garnishment.
Id. at 6 (internal citation omitted); see also Schultz, supra note 9 (quoting Social Security spokesperson who explained that the SSA’s responsibility for protecting benefits ends when they are paid to a beneficiary and that the beneficiary may then cite the exemption law to protect against legal process).
the period when a garnishment order is challenged by the recipient of the federal benefits." The Supreme Court has read this provision quite differently, stating that section 207 of the Social Security Act "imposes a broad bar against the use of any legal process to reach all social security benefits." These diverging interpretations have important consequences for addressing how banks should respond to a garnishment order. Absent clear directives regarding the legality of a temporary freeze, it is understandable that banks choose to follow state law, avoiding potential liability but often at substantial cost to their account holders. At the same time, the technological changes discussed in Part I may, as some courts have concluded, demand a reconsideration of the Due Process and Supremacy Clause issues raised by temporary freezes.

B. Proposed Guidance Issued by the Federal Banking Agencies and Subsequent Comments

The federal banking agencies (Office of the Comptroller of the Currency, Federal Reserve System, FDIC, Office of Thrift Supervision, and National Credit Union Administration) issued a notice and call for comments on September 28, 2007, regarding their Proposed Guidance on Garnishment of Exempt Federal Benefit Funds (the "Proposed Guidance"). Rather than issue firm requirements through regulations binding on the banks, the Proposed Guidance offered a set of best practices "to encourage financial institutions to have policies and procedures in place with respect to handling garnishment orders." These

140 Frozen Out, supra note 11, at 113 (testimony of Montrice Godard Yakimov, Managing Director for Compliance and Consumer Protection, Office of Thrift Supervision).
142 For more on these issues, see the discussion of Mayers v. New York Community Bancorp, supra note 69.
practices included, among others: providing consumers with information regarding which federal benefits are exempt; promptly determining whether an account contains only exempt benefit funds and, if state law permits, refusing a freeze order in such instances; and allowing a consumer access to an amount equivalent to the exempt federal benefits.¹⁴⁵

Banks had mixed feelings in response to these words of encouragement. Although there were some variations in the comments offered by financial institutions and the relevant trade associations, a number of these comments contended that the Proposed Guidance, particularly the call to identify exempt benefits in an account, was impractical, if not impossible, for banks to implement. Capital One Financial Corporation stated that “it is not possible to reliably identify the exempt status of incoming deposits, nor is it possible to reliably identify what amount of a deposit account constitutes exempt federal benefit funds.”¹⁴⁶ Bank of America—asserting that over ninety percent of its accounts that regularly receive federal benefits also received deposits from other sources—contended that a proposal requiring banks to identify and protect accounts that contain only exempt benefits would demand a “staggering” effort on the banks’ part, but provide “minimal” benefits to consumers.¹⁴⁷ The Consumer Banker’s Association offered a similarly frank assessment of the perceived challenges in identifying exempt funds: “Many of what appear to be primary assumptions underlying the practices suggested in the Guidance are flawed and present infeasible or impossible operational challenges.”¹⁴⁸

¹⁴⁵ Id. at 55,275.
These assertions are undermined by the statements of several banks that already voluntarily examine accounts for exempt funds and, when appropriate, refuse to freeze an account. One of the nation’s largest financial institutions, JPMorgan Chase, in its comments on the Proposed Guidance, stated:

"When Chase identifies an account in the name of the judgment debtor that appears to have received only direct deposits of exempt federal benefits over the previous 90 days, we generally notify the judgment creditor or its representative that we have not placed a freeze on the account because it appears to contain only exempt federal benefits." 149

JPMorgan Chase agreed with the Proposed Guidance’s recommendation that banks promptly determine whether an account contains exempt benefits, suggesting, however, that the recommendation “be clarified to require reasonable efforts to identify direct deposits of federal benefit funds, but not check deposits of such funds." 150 A number of other banks have also acknowledged, in separate contexts, that they already investigate and identify directly deposited exempt funds and refuse to freeze accounts containing only such funds. These include New York

149 Comment from Andrea Beggs to Fed. Fin. Regulatory Agencies, supra note 67, at 5. At the same time, JPMorgan Chase noted in its comments “that many banks may not even have the systems capability to readily identify direct deposits of exempt federal benefits.” Id. at 4. In a separate letter from JPMorgan Chase to South Brooklyn Legal Services (“SBLS”), which was submitted with SBLS’s Comment on the Proposed Guidance, the bank similarly described its practices, declaring: “It is standard procedure to review funds in an account prior to placing a restraint.” Letter from M. Tracy Lewis, Executive Specialist, JPMorgan Chase, to Johnson Tyler, S. Brooklyn Legal Servs. (Mar. 14, 2007), attached to Comment from Johnson M. Tyler, Unit Dir., SSI/Disability Right/Special Educ., S. Brooklyn Legal Servs., to Fed. Fin. Regulatory Agencies, Regarding Notice of Proposed Guidance on Garnishment of Exempt Federal Benefit Funds (Nov. 26, 2007). In its comment on the proposed regulation, JPMorgan Chase described its process upon receiving a garnishment order:

When Chase receives a garnishment order, a Chase employee identifies all accounts of the judgment debtor and reviews the account history for the previous 90-day period. We attempt to identify direct deposits of Social Security benefits and veterans’ benefits by reference to the ACH code number and description, if any, accompanying the direct deposit.

Comment from Andrea Beggs to Federal Financial Regulatory Agencies, supra note 67, at 4. Chase also claimed that ACH code numbers are often not sufficiently clear to enable the bank to identify exempt benefit payments and noted that it had expressed this concern to the Social Security Administration and requested guidance on better identifying exempt direct deposit payments. Id. at 4–5.

Community Bank, Astoria Federal Savings, Banco Popular, and Citibank.\footnote{Comment from Johnson M. Tyler to Fed. Fin. Regulatory Agencies, \textit{supra} note 149, at 3; \textit{see also} Office of Fin. Empowerment, N.Y. City Dep't of Consumer Affairs, \textit{supra} note 5, at 4–5 (noting banks that "have publicly acknowledged that they already check the contents of accounts for exempt funds before placing restraints"); Schultz, \textit{supra} note 9 ("Banco Popular says when it gets a garnishment order it looks at account deposits for the past 90 days and if all of them involved exempt funds, it rejects the order. If it finds a mixture of exempt and non-exempt funds, it advises the creditor of this 
...."); Baribeau, \textit{supra} note 64 ("New York Community Bank (NYCB) checks to be sure an account does not consist of exempt funds before freezing it. In an affidavit, John Fennell, NYCB vice president, said the policy 'has been effective in protecting depositors' and has not been a burden to the bank.").} The Pennsylvania Bankers Association, in a recent letter to the Pennsylvania Civil Procedural Rules Committee, also conceded that "where the recurring electronic deposit is Social Security benefits, [the Association's] member banks do have sufficient information to make the identification of those funds, as well as certain other federal benefits, as exempt."\footnote{Letter from Louise A. Rynd, Gen. Counsel, Pa. Bankers Ass'n, to Pa. Civil Procedural Rules Comm., 3 (Nov. 26, 2008), \textit{available at} \url{http://www.pabanker.com/pdfFiles/11-26-08PBAgarnishmentCommentLtr.pdf}. The Pennsylvania Bankers Association noted, however, that while Social Security and other federal benefits are readily identifiable, other funds that lack clear descriptions may prove more difficult to identify. \textit{See id.}}

Advocates on behalf of Social Security recipients have strongly challenged banks' claims regarding the difficulty of identifying exempt funds in an account. AARP, in its comments on the Proposed Guidance, contended that

> deposits solely consisting of federally exempt funds are easily identifiable because the source of the deposit is clearly marked as Federal funds. Additionally, Federal benefit payments only increase 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 only contain exempt funds as those deposits are usually made once a month and are designated as Federal funds.\footnote{Comment from David Certner, Legislative Counsel & Legislative Policy Dir., AARP, to Fed. Fin. Regulatory Agencies, Regarding the Proposed Guidance Entitled Garnishment of Exempt Federal Benefit Funds (Nov. 27, 2007), \textit{available at} \url{http://www.ncua.gov/Resources/RegulationsOpinionsLaws/Comments/Garnishmento ffFedBen/11-27-07-DavidCertner-AARP.pdf}.}

In addition, the New York State Assembly, in the "Justification" section of its bill to protect exempt benefits from restraint, asserted that because electronic deposits identify their source,
banks can easily determine whether an account contains directly deposited exempt income.\textsuperscript{154} Echoing these sentiments, the Social Security Administration, in testimony nearly a decade ago regarding its efforts to encourage direct deposit, stated: "Direct deposit significantly improves payment delivery services. There is an electronic audit trail to ensure that the payment can always be located. Payments can be traced through the banking system and beneficiaries have a permanent record of their payment through their bank records."\textsuperscript{155} Additionally, the Federal Reserve System's regulations, which require financial institutions to send out monthly statements for all accounts "in which an electronic fund transfer has occurred,"\textsuperscript{156} provide further support for the claim that banks can, in practice, identify exempt funds. These required statements must include for each electronic fund transfer: the transfer amount, the date it occurred, the transfer type and the type of account to which it was made, and "the name of any third party to or from whom funds were transferred."\textsuperscript{157}

These statements by the banking community and other stakeholders present conflicting accounts regarding the difficulty of identifying electronically deposited exempt funds. However, the fact that numerous banks have found ways to routinely identify and protect exempt funds indicates that this process need not present an insurmountable challenge. Even accepting that some banks do encounter difficulty in identifying exempt funds, this issue can likely be resolved by clarifying the codes that mark electronic transfers of exempt funds. Such a clarification represents the first component of the proposal offered by this Article. To the extent these statements by banks represent attempts to exaggerate the difficulty of a task they

\textsuperscript{154} SPONSORS MEMORANDUM IN SUPPORT OF LEGISLATION, N.Y. ASSEM., 2008 A.B. 8527A (2008).


\textsuperscript{156} 12 C.F.R. § 205.9(b) (2009).

\textsuperscript{157} Id. In addition, for most transfers made by a consumer at an electronic terminal, the statement must include the location of the terminal. I am indebted to Johnson Tyler for bringing this regulation to my attention.
seek to avoid—out of fear that it will expose them to potential liability—the policy proposal to which we now turn also addresses this concern.

IV. A POLICY TO PROTECT BENEFITS FROM GARNISHMENT AND FREEZES

A federal response is necessary to ensure uniformity in the protections provided to Social Security beneficiaries. Members of Congress have already expressed substantial interest in the issue, as revealed by recent hearings in both the House of Representatives and the Senate.158

They have urged the Treasury Department, in conjunction with other federal financial regulators and the Social Security Administration, to issue regulations addressing the issue.159 During testimony before the House Ways and Means Committee, the Treasury Department stated that it was coordinating an effort to issue regulations addressing garnishments and freezes of bank accounts, an effort that subsequently stalled but is nearing completion as this Article approaches publication.160

158 See Frozen Out, supra note 11 (referencing the Senate Finance Committee’s September 20, 2007 hearing on bank treatment of Social Security benefits); Protecting Social Security Benefits, supra note 18 (referencing House Ways and Means Committee’s June 24, 2008 hearing on protecting Social Security beneficiaries from harmful practices by financial institutions). Senator Baucus, Chairman of the Senate Finance Committee, expressed particularly strong feelings regarding the need to protect exempt benefits:

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

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


159 See Letter from Sens. Kohl & McCaskill to Treasury Sec’y Geithner, supra note 20; see also Letter from Congresspersons Barney Frank, et al. to Timothy F. Geithner, Sec’y, Dep’t of the Treasury 1 (May 13, 2009), available at http://online.wsj.com/public/resources/documents/LetterToGeithner.pdf (urging Treasury Secretary to “revive and expedite the process led by the Department of the Treasury last year to coordinate a multi-agency rulemaking that directs banks on how to respond to court orders issued on behalf of debt collectors to freeze bank accounts containing federally protected funds”).

160 See Protecting Social Security Benefits, supra note 18 (testimony of Gary Grippo, Deputy Assistant Secretary for Fiscal Operations, Treasury Department);
Although well-crafted regulations hold promise, ideally Congress would not leave this issue to federal benefit and financial regulatory agencies. The vital importance of Social Security and other programs to millions of beneficiaries, the unique dangers presented by the confusing morass of varied state garnishment procedures, and the need for strong and clear preemption of conflicting state law all demand a congressional response. This Section provides a framework for shaping such a response and discusses in depth the key issues it must address.

A. Step One: Standardize ACH Coding of Electronic Benefits

As already noted, consumer advocates and bank representatives dispute whether it is easy for a bank to determine if directly deposited funds represent benefits exempt from garnishment. The American Bankers Association (the "ABA"), in its comments on the Proposed Guidance, argued that it is difficult for a bank to identify exempt benefit payments. Although electronic payments—which are disbursed through the Automated Clearing House ("ACH") system—*may* include a code that identifies the sender and type of payment, the ABA contended that the payers of exempt benefits were not required to "consistently and correctly" use standardized payment descriptions. In order to rely on a program that would read such coding, the Association alleges, "all senders of exempt payments must adopt and use consistently a standardized batch header code that clearly identifies a payment as exempt and inform all depository institutions which codes apply to which exempt funds." In a separate letter to the Social Security Administration, the ABA insisted that

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see also Schultz, supra note 27 (describing efforts to revive stalled rulemaking). During his May 13, 2009 confirmation hearing, Michael Barr, Treasury's Assistant Secretary for Financial Institutions, stated that "one of his first priorities will be to issue 'a joint regulation to solve the problem of account freezes and garnishment of exempt funds.'" Id.

161 See supra notes 146–155 and accompanying text.


163 Id. at 7.
establishing distinctive ACH codes, coupled with the use of uniform descriptors, would allow easier identification by bank deposit systems, eliminating the need for manual review.\footnote{See Letter from Mark J. Tenhundfeld, Dir., Office of Regulatory Policy, Am. Bankers Ass'n, to Kristen Schnatterly, Audit Manager, Soc. Sec. Admin., Regarding Solutions to Garnishment of Federal Benefits Payments 4 (May 5, 2008), available at http://www.aba.com/aba/documents/News/Garnishmentletter50508.pdf. One regional bank, Huntington National Bank, attached to its comments on the Proposed Guidance a sample of the batch header codes it had received on a recent day. See Comment from Daniel W. Morton, Senior Vice President & Senior Counsel, Huntington Nat'l Bank, to John C. Dugan, Comptroller of the Currency, and Jennifer J. Johnson, Sec'y, Bd. of Governors of the Fed. Reserve Bank, Regarding Notice of Proposed Guidance on Garnishment of Exempt Federal Benefit Funds app. (Nov. 27, 2007), available at http://www.federalreserve.gov/SECRS/2007/November/20071129/OP-1294/OP-1294_5_1.pdf. The bank offered these representative codes to illustrate that current codes are inadequate to identify whether specific federal payments are exempt. See id. at 4. They noted that there are three different batch header codes used for payments from the Veterans Administration, but only one of these “appear[ed] to be protected from garnishment.” Id. In light of this experience, Huntington Bank asserted that:

While banks learn from experience that some of these codes are in fact for particular types of federal benefit payments, reliance on that type of experience will not pick up everything and will not eliminate the guesswork that must underlie any programming that relies on such codes as presently provided. Furthermore, it is our understanding that the content of the “entry description” field is whatever the sender puts there, and if changes are made to such codes, any previous programming by the receiving bank to pick up those codes would no longer do so. In order for codes to be part of the solution, all senders of exempt payments must adopt and use consistently a standardized batch header code that clearly identifies a payment as exempt and inform all depository institutions which codes apply to which exempt funds.

Id. at 4–5; see also Comment from Kathleen Kloiber Koch to Fed. Fin. Regulatory Agencies, supra note 147, at 6 (requesting “[s]pecific and easily identifiable ACH codes and descriptions for all exempt federal benefit payments.”).}

In a similar vein, the Community Banker's Association contended in its comments on the Proposed Guidance that “While codes currently exist to identify [benefit] payments, they lack the clarity needed to create the fully operational automated systems that are necessary to handle the extensive volume of garnishments received by financial institutions.”\footnote{Comment from Joseph R. Crouse to Fed. Fin. Regulatory Agencies, supra note 148, at 4.} In their own comments on the Proposed Guidance, other trade associations
and individual banks made similar appeals for standardized coding of electronic deposits and specific codes to identify exempt funds.\textsuperscript{166}

Regardless of whether identifying exempt electronic benefits currently is or is not an easy task, the Treasury Department and the relevant benefit agencies (for example, Social Security and the Veterans Administration) should review, clarify, and, where necessary, standardize both the descriptors and the ACH coding for direct deposits of exempt benefits. This clarification would require minimal effort and cost. In addition to identifying the type of benefit, these codes should expressly identify the funds as exempt and, as will be discussed below, the number of recipients entitled to a specific benefit—a particular concern in the context of survivor benefits. Clarified coding will enable banks to more easily comply with the requirements of a new federal policy, thereby justifying stricter methods for enforcing compliance.\textsuperscript{167}

Improved coding can also, as some banks have indicated, allow for greater automation and, hence, streamline the processing of garnishment orders and reduce the costs of applying an automatic exemption system.\textsuperscript{168}


\textsuperscript{167} See infra text following note 220.

\textsuperscript{168} See, e.g., Comment from Kathleen Kloiber Koch to Fed. Fin. Regulatory Agencies, supra note 147, at 6 ("Banks will rely on the codes and descriptions to develop programming to detect and flag these deposits."); Comment from Richard Whiting, Executive Dir. and Gen. Counsel, Fin. Servs. Roundtable, to Fed. Fin. Regulatory Agencies, Regarding Proposed Guidance on Garnishment of Exempt Federal Benefit Funds 3 (Nov. 27, 2007), available at http://www.fsrround.org/policy/regulatory/pdfs/Roundtablecomments_guidanceonGarnishments_final.pdf (suggesting that new regulations should include "potential improvements to the ACH system so that each separate type of federal benefit direct deposit has a unique identifying code that the receiving bank can map to a system flag so as to be able to systematically and reliably identify that an account is receiving direct deposit of federal benefit funds without having to review the transaction history, and requiring
B. Step Two: Institute an Automatic Exemption—of a Set Multiple of the Exempt Benefit Amount—for Accounts That Receive Electronically Deposited Exempt Federal Benefits

1. An Automatic Exemption System Is Superior to the Alternatives

An automatic exemption system provides a number of advantages over a system—like that found in the Proposed Guidance and implemented by some states—that would require banks to examine an account and refuse to freeze an amount equivalent to only the exempt benefits in the account. An automatic exemption is easier to apply and would likely lead to more rapid and consistent compliance. It would ensure that recipients' benefits are not interrupted, even for a short period, while a bank or other party determines what portion of an account derives from exempt benefit funds. At the same time, it would avoid the potential difficulties caused by accounting errors on the part of a financial institution or other party attempting to determine the precise amount of an account that is exempt. Finally, an automatic exemption would make it easier for regulators to monitor bank compliance.

In their comments on the Proposed Guidance, a number of banks and banking associations voiced their support for an automatic exemption system similar to that of California, Connecticut, and New York. In advocating for something akin to the Connecticut law, the American Bankers Association stated:

This approach enables the customer to have access to funds to live on while the dispute is resolved, and it provides a comparatively simple, clear rule that provides the bank with the protection that it needs. Such an approach, adopted at the federal level and preempting inconsistent state laws, would be a more effective way to strike the appropriate balance between the rights of creditors and debtors, respectively, while building on those steps that banks can actually take to play a constructive role.

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the federal benefit agencies to use such codes, and allowing receiving banks to ignore benefit funds that fail to include the codes

169 See supra Part I.B.

170 Comment from Mark Tenhundfeld & Krista Shonk to Fed. Fin. Regulatory Agencies, supra note 162, at 10 (internal citation omitted).
Bank of America expressed similar sentiments regarding the California model, noting that it simplified the required research and allowed banks to avoid determining the status of commingled funds. JPMorgan Chase, which, as previously noted, voluntarily examines accounts for exempt benefits and refuses an order to freeze or garnish accounts containing only exempt funds, also endorsed an approach similar to the California and Connecticut statutes. Chase proposed that the federal benefit agencies, including the Social Security Administration, could implement a similar system through preemptive regulations and expressed its support for such regulations.

2. Congress, Rather than Federal Agencies, Should Establish the Automatic Exemption System

It is not clear, however, that the benefit agencies—or federal agencies in general—are the proper entities to institute such a system. Agency regulatory actions must conform to the particular authority granted to an agency by its governing statute. Courts have the power to review and to enjoin ultra vires agency action—action “in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.” It might be argued that the Social Security Administration and the other relevant benefit agencies would act ultra vires to their statutory authority were they to attempt to create an automatic exemption system similar to those implemented in New York, California, and Connecticut. These systems go beyond merely prohibiting freezes of statutorily exempt benefits and instead create a new exemption that extends to all funds, whether already statutorily

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171 See Comment from Kathleen Kloiber Koch to Fed. Fin. Regulatory Agencies, supra note 147, at 6, 8.

172 Comment from Andrea Beggs to Fed. Fin. Regulatory Agencies, supra note 67 at 2, 5, 8.

173 Id. at 2, 8, 9.

174 Although no details have been revealed, it appears that the regulations being considered by the Department of the Treasury do not include an automatic exemption system like the one advocated by this Article. See Schultz, supra note 27 (describing general outline of potential regulations and noting that the proposals have not been released).

exempt or not. Such provisions, which rely on the state's broad police powers, would exceed an agency's authority to implement the provisions of its governing statute.

Nor would agency regulations creating an automatic exemption system likely represent a mere interpretation of the Social Security Administration's governing statute. When an agency's interpretation of the statute it administers is challenged in court, the courts typically apply the deferential standard of review delineated by the Supreme Court in *Chevron v. Natural Resources Defense Council, Inc.*176 The two-step *Chevron* review first asks whether Congress spoke directly to the precise question at issue.177 If Congress has unambiguously expressed its intent, then the court, as well as the relevant federal agency, must effectuate this intent.178 This leaves no need to move to step two. But, when Congress has not clearly addressed the relevant issue—the statute is either silent or ambiguous—the court must ask "whether the agency's answer is based on a permissible construction of the statute."179 A court must defer to an agency's regulation, even if the court itself would have interpreted the relevant statute differently, so long as that regulation is not "arbitrary, capricious, or manifestly contrary to the statute."180

The Social Security Act states that "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."181 This statute is arguably silent on two key issues: whether its protections represent an absolute prohibition of the legal processes listed or simply an affirmative defense to be raised by a debtor facing such legal processes, and whether a freeze—which may not result in the transfer of funds into another party's possession—represents an "other legal process."182 According to the federal banking agencies, in their

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176 467 U.S. 837, 844 (1984); see also FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 132 (2000) (noting that *Chevron* governs the analysis of cases involving "an administrative agency's construction of a statute that it administers").
177 467 U.S. at 842–43.
178 Id.
179 Id. at 843.
180 Id. at 844.
181 42 U.S.C § 407 (2006). The "subchapter" referred to is Subchapter II (Federal Old-Age, Survivors, and Disability Insurance Benefits) of Chapter 7 (Social Security) of Title 42 (Public Health and Welfare) of the U.S. Code. Id.
182 Of course, some have contended that the statute should be read to clearly and unambiguously represent an absolute prohibition and to include within the scope of
congressional testimony, the Social Security Administration has interpreted these protections as affirmative defenses to be raised by a benefit recipient, rather than absolute bars that prohibit outright any act of attaching or freezing a bank account containing exempt benefits. The Social Security Administration's own literature and website confirm that this appears to be the agency's reading of the statute. This interpretation, which itself does not specify how the statutory

"other legal process" any actions that deny a Social Security recipient access to her benefits, whether temporarily or permanently. The Supreme Court has itself stated that the law represents a "broad bar." Philpott v. Essex County Welfare Bd., 409 U.S. 413, 417 (1973), superseded by statute, 42 U.S.C.A. § 1383(g) (West 2009). It has also discussed the meaning of "other legal process," stating that this should be understood to be process much like the processes of execution, levy, attachment, and garnishment, and at a minimum, would seem to require utilization of some judicial or quasi-judicial mechanism, though not necessarily an elaborate one, by which control over property passes from one person to another in order to discharge or secure discharge of an allegedly existing or anticipated liability. Wash. State Dep't of Soc. & Health Servs. v. Keffeler, 537 U.S. 371, 385 (2003). Read narrowly this definition would not appear to include a temporary freeze of funds, during which their exempt status is determined, as such a freeze does not transfer control over property "in order to discharge or secure discharge" of a liability. Id. However, such a narrow reading may not be merited; for the purpose of a freeze is to prevent an account holder/judgment debtor from removing funds and thereby avoiding liability. As such, the freeze could certainly be understood as a transfer of control from the account holder to the financial institution itself in order to "secure discharge" of the liability by ensuring that the funds are not removed. Id. A broader reading also better accords with the Supreme Court's recognition that legislation providing for federal benefits "should be liberally construed ... to protect funds granted by the Congress for the mainentance and support of the beneficiaries thereof." Porter v. Aetna Cas. & Sur. Co., 370 U.S. 159, 162 (1962).

1 See supra notes 126–129 and accompanying text.

2 See Social Security Online, Direct Deposit Frequently Asked Questions, http://www.ssa.gov/deposit/DDFAQ898.htm (last visited Mar. 24, 2010) ("The Social Security Administration's responsibility for protecting benefits against legal process and assignment usually ends when the beneficiary is paid. . . . If 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. You also may want to provide this same information to your financial institution and seek legal assistance if you believe it is needed."); see also OFFICE OF THE INSPECTOR GEN., SOC. SEC. ADMIN., supra note 35, at 11 (observing, based on Social Security Administration's website, that "it appears 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 an absolute bar against the imposition of the freeze or hold"). The Office of the Inspector General's report suggested that the Social Security Administration revisit this interpretation and stated that "If SSA interprets the garnishment exemption provision as an absolute bar, then FI regulators (such as Treasury, Federal Deposit Insurance Corporation, Credit Unions etc.) need to enforce SSA's interpretation." Id.
protections are to be implemented, satisfies the deferential standard of review articulated by Chevron. At the same time, it is very likely that, if the Social Security Administration were to change its interpretation and state that § 407 absolutely bars any action to attach or garnish an account, this too would be found to represent a "permissible construction of the statute." Both interpretations, and any formal regulations that implement them, simply represent an agency's policy decision regarding the best way in which to effectuate Congress's intent to protect exempt benefit funds from attachment, garnishment, and other legal procedures. Ensuring that banks themselves examine accounts and refuse an order to freeze exempt benefit funds might require further regulations by the federal banking agencies. Still, a solution of this kind could be implemented through joint action by the benefit and banking agencies—without congressional action.

In contrast, a protection like that provided in California, Connecticut, and New York could not properly be implemented through agency action. Rather than simply ensuring the protection of exempt benefit funds and only those funds, these solutions create a new exemption, which often may extend to money that would not otherwise be exempt. These state solutions define a specific amount of money that will be automatically protected from attachment and garnishment, regardless of its source, so long as it is in an account that contains electronically deposited exempt funds. In doing so, these statutes create a protection that goes beyond that provided by § 407 of the Social Security Act and analogous federal benefit statutes. Although, as discussed earlier, the protections in § 407 reflect Congress's intent to ensure that benefit recipients retain the funds needed for subsistence living, and the state solutions further this underlying goal, § 407 seeks to pursue this broad goal in a specific way: by exempting particular federal benefits from collection. If a solution similar to that in California, Connecticut, and New York were to be attempted through agency

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185 Chevron, 467 U.S. at 843.
186 See Frozen Out, supra note 11, at 11 (statement of Sara A. Kelsey, General Counsel, FDIC) (stating that if the Social Security Administration and Veteran's Administration "were to provide interpretations of law [regarding garnishment], the FDIC and other banking regulators would then be able to enforce these interpretations under our general enforcement authority").
regulation, such regulation could be challenged as going beyond a "permissible construction" of the relevant statutes or as simply ultra vires. As such, it would be in danger of being declared invalid.\textsuperscript{187}

These concerns regarding agency authority perhaps underlie the reactions of the federal benefit and banking agencies to calls for regulation to solve the garnishment issue. In its testimony before the Senate Finance Committee, the FDIC argued that while they are working to address concerns about protecting exempt funds, "bank regulators currently lack adequate legal authority to effectuate a comprehensive solution to the issues raised by garnishment."\textsuperscript{188} At the same time, the Social Security Administration has concluded that while the language of § 407 of the Social Security Act is clear, it "does not provide us with any means for enforcement and does not establish any penalties for its violation."\textsuperscript{189} These statements might reveal mere reluctance on the part of individual agencies to engage in the challenging task of crafting an adequate solution, coupled with a desire to push the issue into the realm of a different agency. However, they may also indicate that, perhaps in part due to recent changes in technology, federal agencies lack clarity regarding their obligations in effectuating the goals that originally motivated Congress's statutory protections of exempt benefits. At the very least, these statements indicate that resolving this issue will require policy proscriptions that impinge upon the respective jurisdictions of both federal benefit agencies and federal financial regulators.

A federal solution—in order to achieve uniform results nationwide and avoid the banks' concerns regarding the arguably irreconcilable requirements of federal and state legislation—must clearly preempt conflicting state law. Preemption raises a

\textsuperscript{187} The Virginia Bankers Association, in its successful campaign reversing a protection for exempt benefits instituted by the state judiciary, contended in part that the change was not authorized by the relevant statute. \textit{See Kuehner-Herbert, supra} note 77.

\textsuperscript{188} \textit{Frozen Out, supra} note 11, at 7-8 (statement of Sara A. Kelsey, General Counsel, FDIC). Implicitly noting the limits on agency action, Ms. Kelsey later discusses the possibility of a \textit{statutory} solution "mandat[ing] that certain minimum amounts in such accounts could not be frozen, garnished, or attached," before discussing possible agency action. \textit{Id.} at 10-11.

\textsuperscript{189} \textit{Protecting Social Security Benefits, supra} note 18 (statement of Marianna LaCanfora).
separate legal concern that would more effectively be resolved by congressional action, rather than agency regulation. Although a properly promulgated agency regulation will preempt a conflicting state law, it is not clear whether an agency's interpretation of the preemptive effect of its own regulations, or of a particular statute, is entitled to deference by the courts.\textsuperscript{190} Justice Stevens, dissenting in \textit{Watters v. Wachovia}, discussed this issue, which the majority opinion avoided: Should an agency be given deference when it purports to settle a question of federal preemption of state law?\textsuperscript{191} Stevens declared that such deference would be misplaced, in part because agencies, unlike Congress, do not adequately represent the interests of the states whose laws they may preempt.\textsuperscript{192} This uncertainty provides further reason to prefer a congressional resolution, which can speak more authoritatively to the issue of preemption.

These considerations—as well as the complex interplay of laws governing public benefits, banking, debt collection, and state procedures—argue in favor of congressional action to resolve this issue. Such action would better ensure that the policy goals that compelled Congress to institute § 407 and similar provisions are adequately effectuated and that the interests of benefits recipients, creditors, banks, and state and federal courts are properly balanced. Nonetheless, a joint agency regulation, issued after significant consultation with key players, that incorporates many of the elements in this proposal could provide a second-best option and might prove more politically feasible.


\textsuperscript{191} 550 U.S. 1, 38 (2007) (Stevens, J., dissenting).

\textsuperscript{192} See \textit{id.} at 41 (quoting Geier v. American Honda Motor Co., 529 U.S. 861, 908 (2000) (Stevens, J., dissenting)). Justice Stevens's dissent in \textit{Watters} resonates with prior decisions by the Court: "With \textit{Watters} added to this mix, a majority of justices on the Court have rejected the applicability of \textit{Chevron} deference to preemption determinations [made by agencies] (Chief Justice Roberts and Justices Stevens and Scalia in \textit{Watters}) or at least expressed skepticism or concerns about deferring in such circumstances." Quester & Keest, \textit{supra} note 190, at 208–09.
3. Determining the Proper Size of an Automatic Exemption

Setting the proper monetary amount for an automatic exemption requires consideration of factors, including: the length of time it takes to establish whether remaining funds are exempt from collection and thus a freeze should be lifted, the size of monthly benefit payments, the amount of money benefit recipients need to provide for their basic needs over a set period of time, and the rights of creditors to nonexempt funds that might be in an account.

States vary in the procedures through which benefit recipients can challenge a garnishment order and claim additional exemptions. The California, Connecticut, New York, and Oregon automatic exemption statutes each provide procedures for an account holder to assert exemptions in relation to any money in the account that exceeds the automatic exemption. In Connecticut, these remaining funds are restrained until a court order is issued or at the end of forty-five days. New York offers a more streamlined system, through which funds should be released within a maximum of thirty days. Given the very real possibility of delay, including a delay on the part of a bank or the judgment creditor in releasing an account, it would be reasonable to institute an automatic exemption that would provide sufficient funds for an individual to survive forty-five days without access to the funds in his or her account that exceed the automatic exemption amount. The size of a recipient’s exempt benefits can vary dramatically. As the table below reveals, for SSI and Social Security alone, an individual’s benefits may range from $674 for an SSI recipient to a maximum of $2,323 monthly for some Social Security recipients. This variance might appear to render the establishment of a constant automatic exemption amount rather arbitrary. The task might be simplified by focusing on the purpose of the § 407 exemption: ensuring the resources necessary to meet basic needs (which the poverty guidelines in the table below might be deemed to represent). At the same time, if the automatic exemption is to

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193 See supra notes 40–44 and accompanying text.
194 See supra notes 103–112 and accompanying text.
195 Although any additional deposits of exempt benefits that occur subsequent to the service of the garnishment order should remain accessible to the account holder, an allowance should be made for the possibility that a bank will fail to ensure that such funds remain available.
further the express goals of § 407—protecting exempt benefits themselves—it should at least protect the amount of an average Social Security benefit received during the estimated maximum potential length of a freeze. The forty-five-day period discussed above would represent roughly one and one-half months. Taking the benefit of an average retired worker—$1,155—and multiplying it by this period yields $1,733. Given that an individual might have additional exempt money in the account, and also might need to obtain the services of an attorney or incur other costs in relation to raising this exemption, it would be reasonable to protect some additional funds for this purpose. For the sake of clarity, $2,000 might represent a proper amount for a national automatic exemption.196

<table>
<thead>
<tr>
<th>Social Security and Supplemental Security Income Monthly Benefit Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Average Benefit – Individual Retired Worker</td>
</tr>
<tr>
<td>• Average Benefit – Individual Disabled Worker</td>
</tr>
<tr>
<td>• Average Benefit – Widowed Mother with Two Children</td>
</tr>
<tr>
<td>• Average Benefit – Disabled Worker, Young Spouse,</td>
</tr>
<tr>
<td>and One or More Children</td>
</tr>
<tr>
<td>• Supplemental Security Income, Individual Recipient</td>
</tr>
<tr>
<td>• Maximum Monthly Social Security Benefit (2009)</td>
</tr>
<tr>
<td>• Department of Health and Human Services</td>
</tr>
<tr>
<td>Individual Poverty Guideline (2009)</td>
</tr>
</tbody>
</table>

This amount should serve to ensure that a recipient will have the funds necessary to live for up to forty-five days without access to her funds. At the same time, because it is not too high, it makes it possible that nonexempt funds in an account will

remain frozen, allowing a judgment creditor with a legitimate claim access to any nonexempt funds that exceed the automatic exemption amount.

Survivor benefits, which may be paid to multiple people, complicate this picture. A widow with two children receives an average benefit of $2,379. Hence, a $2,000 automatic exemption would not protect a sufficient amount of money for a forty-five day period. California's statute, which establishes different sizes of automatic exemptions depending on the number of designated payees, provides a possible solution to this concern.\textsuperscript{197} Changes in ACH could take the possibility of multiple beneficiaries into account and ensure that new codes indicate the number of payees receiving a specific benefit payment. The size of an automatic exemption could then increase when benefits are intended for multiple beneficiaries.

Although California, Connecticut, and New York have focused on a fixed amount for an automatic exemption (with some variations in the California system), this is not the only viable approach. Given the concerns just discussed, a better approach, which this Article advocates, would be to protect a set multiple of the actual benefits electronically deposited into a given account—a system partially embraced by the Oregon legislation.\textsuperscript{198} Congress could require banks to, upon determining that an account contains directly deposited exempt funds, also identify the amount of the last such deposit. Banks should be required to then refuse to freeze a certain multiple—perhaps two times—of the amount of the last direct deposit of exempt funds. This would allow the size of this protection to account for differences in the amount of exempt benefits received. By fixing the exemption amount to the size of benefit payments, it would also better accommodate for inflation and changes in the cost of living, without requiring subsequent regulatory adjustments.

\textsuperscript{197} See supra notes 111–113.

\textsuperscript{198} Oregon. S.B. 731 provides that a bank may not garnish an amount equal to the amount of exempt payments deposited into the account during the calendar month preceding the delivery of the writ of garnishment to the bank. See S.B. 731 § 2(1) (Or. 2009). As noted supra, notes 108 and from 115 to 117, the Oregon legislation, in addition to protecting exempt payments "that a financial institution can identify ... from information transmitted to the financial institution by the payor," id. § 2(3)(a), also requires financial institutions to make available to account holders an affidavit form, which may be used to indicate that the customer is receiving exempt benefits paid by direct deposit. Id. § 2(4)(b).
C. Step Three: Clarify How Commingled Funds Should Be Treated

Federal and state courts, when confronted with the need to trace commingled funds in a bank account, have applied various accounting methods to determine how much of an account is attributable to a particular source. A new federal policy should mandate the application of a specific accounting method—first in, first out—for determining the status of commingled funds in accounts containing exempt benefits. This would avoid the confusion and delay caused by uncertainty regarding the proper method to apply.

1. The Advantages and Simplicity of First in, First out Accounting

Many courts already apply the “first in, first out” rule of accounting when confronted with commingled Social Security benefits. This method is also embraced by the Uniform Commercial Code and by the Connecticut automatic exemption statute, for determining the status of any funds beyond the $1,000 automatic exemption, and by the Oregon bill for distinguishing among commingled funds. When this system is applied, the funds in an account are deemed to be withdrawn in the exact order in which they were deposited. Under this

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199 See, e.g., In re MJK Clearing, Inc., 371 F.3d 397, 401–03 (8th Cir. 2004) (using “lowest intermediate balance” rule to trace trust funds deposited into a general account); In re Foster, 275 F.3d 924, 927 (10th Cir. 2001) (same); NCNB Fin. Servs., Inc. v. Shumate, 829 F. Supp. 178, 181 (W.D. Va. 1993) (applying “first in, first out” accounting method), aff’d, 43 F.3d 1468 (4th Cir. 1994); Lincoln Fin. Servs., Inc. v. Miceli, 17 Misc. 3d 1109(A), 851 N.Y.S.2d 58 (Dist. Ct. Nassau County 2007) (applying New York State’s “first-in, first-out” rule to determine amount of exempt funds in a commingled account); In re Lichtenberger, 337 B.R. 322, 324 (Bankr. C.D. Ill. 2006) (noting, in cases tracing commingled exempt funds, that “[t]here are four methods that courts routinely employ in tracing funds: (i) the lowest intermediate balance approach, (ii) the last-in, first-out approach, (iii) the pro-rata approach, and (iv) the first-in, first-out approach”).


201 U.C.C. § 4-210(b) (2002) (“For the purpose of this section, credits first given are first withdrawn.”).

202 CONN. GEN. STAT. § 52-367b(j) (2008) (“If both exempt and nonexempt moneys have been deposited into an account, for the purposes of determining which moneys are exempt under this section, the moneys most recently deposited as of the time the execution is served shall be deemed to be the moneys remaining in the account.”); S.B. 731 § 4(4) (Or. 2009) (“For the purpose of identifying exempt funds in an account, first in, first out accounting principles shall be used.”).
method, an account “will be completely exempt if the current balance is equal to or less than the last direct deposit and no subsequent deposits were made.” The following table depicts how this accounting system works. This example assumes a jurisdiction without an automatic exemption, but this same accounting also could be applied, if such a system were in place, to the excess money above the automatic statutory exemption.

An Example of the First in, First out Accounting Method

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Deposit</th>
<th>Withdrawal</th>
<th>Exempt Funds in Account</th>
<th>Nonexempt Funds in Account</th>
<th>Total Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$500 exempt</td>
<td>$500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>$200 not exempt</td>
<td></td>
<td>$500</td>
<td>$200</td>
<td>$700</td>
</tr>
<tr>
<td>3</td>
<td></td>
<td>$300</td>
<td>$200</td>
<td></td>
<td>$400</td>
</tr>
<tr>
<td>4</td>
<td>$500 exempt</td>
<td></td>
<td>$700</td>
<td>$200</td>
<td>$900</td>
</tr>
<tr>
<td>5</td>
<td>$100 not exempt</td>
<td></td>
<td>$700</td>
<td>$300</td>
<td>$1,000</td>
</tr>
<tr>
<td>6</td>
<td></td>
<td>$400</td>
<td>$500</td>
<td>$100</td>
<td>$600</td>
</tr>
</tbody>
</table>

In this simplified example, the initial deposit—of $500 in exempt funds—is the first in the account. The withdrawals then count against this deposit until it is exhausted. At that point, they begin to reduce the second deposit—of $200 in nonexempt funds. This example may seem overly simplistic, given it involves only six transactions. However, this method can also be used with any account to track money going backwards. We merely look at the total balance on the last day, here $600, and add the deposits going backwards in time until we have total deposits that equal this total balance. In this case, this would be satisfied by the last two deposits—Transactions 4 and 5. These deposits represent the amount of exempt funds and nonexempt funds that remain in the account using a “first in, first out” accounting method: $500 and $100 respectively.

204 Author’s calculation.
Although it offers valuable clarity, this accounting system can lead to potentially disparate results in quite similar situations. For instance, using the example above, if this account was garnished immediately after the $300 withdrawal (Transaction 3), that entire withdrawal would count against the exempt funds, leaving an individual with $400 in the account—only half of which, at the time of garnishment, is exempt. If we change the example by switching the order of the first two transactions so that the $200 in nonexempt funds is deposited before the $500 in exempt funds, this situation changes dramatically. Now the withdrawal counts against $200 in nonexempt funds and only $100 in exempt funds. In this situation, if the account is frozen after the third transaction, the account holder will be able to claim an exemption for all $400 in the account, leaving the judgment creditor with nothing.

Such a system might be considered inequitable, as a judgment debtor would appear to face substantially different liability depending on the vagaries of time. Differences in liability might hinge upon whether she made a deposit of nonexempt funds before or after her last direct deposit of exempt benefits or upon when a garnishment order was served in relation to her last direct deposit of exempt benefits. Given the strong federal interest in protecting exempt benefits from garnishment, it would seem that accounting for commingled funds should not depend upon such seemingly arbitrary timing issues. However, such examples are likely to be rare. Moreover, these discrepancies would have less of an impact on account holders who are already benefiting from an automatic exemption. The first in, first out method is also, as will be discussed next, substantially easier to apply than other accounting methods. For these reasons, it represents the best choice for resolving the problems caused by commingled funds.


Under the New York law, when an account contains commingled funds that exceed the $2,500 exemption, a judgment creditor, after receiving from the debtor an exemption claim form and proof of exemption, must apply the lowest intermediate balance principle of accounting and then instruct the bank to
release any exempt money. The lowest intermediate balance principle is borrowed from the law of trusts. Under this rule, the amount of a traced deposit that remains in an account is equal to the lesser of the full amount of the deposit itself or the lowest balance in the account at any time between the deposit and the present. If you are tracing a $200 deposit of exempt funds and the account has never fallen below $200 since the deposit was made, then the full $200 is considered to still be in the account. However, if the account dropped to $50 and is now at $150 due to subsequent deposits of other funds, then the amount of the traced funds in the account is only the “lowest intermediate balance”—which is $50.

This method is clear in this example but would involve too much complication in the context of a commingled account featuring multiple exempt and nonexempt deposits. Moreover, the New York law does not explain precisely how this method is to be applied in the context of exempt funds, particularly when those funds exceed the automatic exemption, and therefore, necessarily represent the proceeds of multiple benefit payments. To account for such instances, new legislation would need to establish a set “look-back period,” which would

206 See N.Y. C.P.L.R 5222-a(c)(4) (McKinney 2009).

j. Effect of withdrawals and subsequent additions. Where the trustee deposits in a single account in a bank trust funds and his individual funds, and makes withdrawals from the deposit and dissipates the money so withdrawn, and subsequently makes additional deposits of his individual funds in the account, the beneficiary cannot ordinarily enforce an equitable lien upon the deposit for a sum greater than the lowest intermediate balance of the deposit. If the amount on deposit at all times after the deposit of the trust funds equalled or exceeded the amount of trust funds deposited, the beneficiary is entitled to a lien upon the deposit for the full amount of the trust funds deposited in the account. If after the deposit of trust funds in the account the deposit was wholly exhausted by withdrawals before subsequent deposits of the trustee’s individual funds were made, the beneficiary’s lien upon the deposit is extinguished, and if he is unable to trace the money withdrawn, he is relegated to a mere personal claim against the trustee, and is entitled to no priority over other creditors of the trustee.

Id.

limit how far back in time an account must be examined in order to determine the total amount of funds to be traced. This system would prove more difficult to implement than the first in, first out system, which only requires that account deposits be examined far enough back in time to account for the amount of money that presently remains in the account. The complexity of applying the lowest intermediate balance rule, including the possibility of confusion or accounting errors, provides further support for choosing the first in, first out method.

D. Step Four: Limit the Number of Times an Account May Be Frozen

In some states, most notably New York, it is easy and costless for a creditor to issue a restraining notice on a bank and freeze an account.\textsuperscript{208} An account can be restrained multiple times in a single year by a judgment creditor, causing hardship to both benefit recipients and the financial institutions that must process these restraints.\textsuperscript{209} To partially remedy this, the New York automatic exemption legislation provides that a judgment creditor may serve a bank account with no more than two restraining notices in a single year and requires court permission to serve the second notice.\textsuperscript{210} Connecticut’s statute attempts to limit the volume of restraints by requiring that a party seeking to execute a garnishment order apply to a court and pay a $35 fee, which can be recovered from the debtor.\textsuperscript{211}

\textsuperscript{208} See CMTY. DEV. PROJECT, THE URBAN JUSTICE CTR., \textit{supra} note 43, at 4; \textit{see also} Furst & McGuire, \textit{supra} note 45; \textit{supra} note 66 (providing sources describing New York garnishment process).

\textsuperscript{209} In the \textit{Mayers} decision, the court recounted the plaintiffs’ allegations that their bank accounts were restrained numerous times. Mayers v. N.Y. Cmty. Bancorp, Inc., No. CV-03-5837 (CPS), 2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005), at *5–11. Each of the three plaintiffs alleged that they had been subject to three separate restraints on their bank accounts in an attempt to collect a judgment against them. \textit{Id.} As a result, they found themselves repeatedly subject to fees for bounced checks, fees for the implementation of the account restraint, and late payment fees. \textit{Id.}

\textsuperscript{210} N.Y. C.P.L.R. 5222(c) (McKinney 2009) (“Leave of court is required to serve more than one restraining notice upon the same person with respect to the same judgment or order. A judgment creditor shall not serve more than two restraining notices per year upon a natural person’s banking institution account.”); \textit{see also} Calabrese & Keefe, \textit{supra} note 110, at 12.

\textsuperscript{211} CONN. GEN. STAT. § 52-367b(b) (2008).
To help remedy the problem of multiple garnishments and avoid the costs these fishing expeditions can impose on banks, courts, and benefit recipients, a federal policy should impose a fine or other penalty on judgment creditors who repeatedly serve a restraining notice on the same bank account after being informed that the account contains only exempt funds. Another possible solution would require these judgment creditors to file an affidavit offering a reasonable basis for believing that the account contains nonexempt funds.\textsuperscript{212} Ohio state law formerly required an affidavit of this sort for any garnishment of property to be commenced.\textsuperscript{213} The affidavit, signed by the judgment creditor or his attorney, was required to state "[t]hat the affiant has a reasonable basis to believe that the person named in the affidavit as the garnishee may have property, other than personal earnings, of the judgment debtor that is not exempt under the law of this state or the United States."\textsuperscript{214}

Given the potential difficulty with policing a fine system, the most effective way to prevent repeated garnishments may simply be to require banks to flag accounts as exempt the first time an automatic exemption is applied to an account and the funds in the account are less than the automatic exemption amount or any excess funds are entirely exempt.\textsuperscript{215} The bank would then be required to automatically return as unenforceable any subsequent garnishment order directed at that account. If a collector subsequently wishes to serve a new garnishment order, and to allege that the funds in the account have changed

\textsuperscript{212} Cf. Betts v. Tom, 431 F. Supp. 1369, 1377–78 (D.C. Haw. 1977) (discussing, in context of Aid to Families with Dependent Children grant, the value of procedures that include use of an affidavit setting forth the creditor’s beliefs regarding the source of funds in an account before issuance of writ of garnishment).

\textsuperscript{213} This provision, which had been in OHIO REV. CODE ANN. § 2716.11 (2008), was removed effective September 30, 2008. See Stewart v. Cheek & Zeehanelar, LLP, 252 F.R.D. 387, 389 (S.D. Ohio 2008) (describing prior law); id. at 389 n.1 (noting that new version of law dispenses with the “reasonable basis” requirement). This change may have been motivated by the Sixth Circuit’s decision in Todd v. Weltman, Weinberg & Reis Co., 434 F.3d 432, 434 (6th Cir. 2006), which upheld a district court decision denying absolute immunity to the defendant—a creditor’s law firm—in a case alleging that the defendant had no factual basis for the affidavit stating its belief that plaintiff’s bank account contained nonexempt assets.

\textsuperscript{214} 2008 OHIO LAWS 122 (West 2009) (noting changes to Ohio Statute 2716.11 and to language in state’s "Order and Notice of Garnishment of Property other than Personal Earnings and Answer of Garnishee" form); see also Stewart, 252 F.R.D. at 389.

\textsuperscript{215} See supra note 168 (discussing banks’ use of account flags).
sufficiently to justify a new collection attempt, they would be required to complete an appropriate affidavit and receive permission from a court to issue a new garnishment order.

E. Step Five: Protect Banks from Liability, but Hold Them Liable for Failing To Comply

1. Protect Banks from Liability Through a Safe Harbor Provision

When they receive a court order to attach or garnish an individual's bank account, banks find themselves caught between the requirements of federal laws that exempt benefits from attachment and state laws that threaten to hold banks in contempt or financially liable for failing to attach an account.216 A bank that fails to prevent an account holder from withdrawing funds after the bank has received a garnishment order may, in certain states, be held financially liable for the value of the judgment.217 However, in nearly all states, these penalties explicitly do not apply to a bank that refuses to attach exempt funds.218 Nor is there clear evidence that any bank has ever been subject to a penalty for such a refusal.219 Nonetheless, in light of this ambiguity, it is perhaps understandable that banks express reluctance to refuse an order to attach an account.

In their comments on the proposed garnishment regulations, members of the banking community expressed their desire for a safe harbor that would protect banks from liability to either the

216 See, e.g., 231 PA. CODE § 3111(d) (2009) (providing that a garnishee may be held in contempt for failing to comply with a writ of garnishment); see also Comment from Robert G. Rowe, III to Fed. Fin. Regulatory Agencies, supra note 166, at 3; Comment from Richard Whiting to Fed. Fin. Regulatory Agencies, supra note 168, at 2.


218 See Frozen Out, supra note 11, at 6 (testimony of National Consumer Law Center). The National Consumer Law Center, in congressional testimony, shared its detailed review of state exemption laws. It concluded that in all states except three, in which the issue is somewhat ambiguous, a bank is required to attach only nonexempt funds. Id. The Center also reported that it had never heard of a case in which banks suffered even just a legal inquiry for refusing to honor an order. Id. The banks and banking associations that have voiced this concern have not offered specific cases in which a bank has faced such liability.

219 See id.
judgment creditor or the account holder if they wrongfully interpreted or applied an exemption. A federal law mandating that banks review accounts for electronically deposited exempt benefits and refuse to freeze such funds should, in light of the Supremacy Clause, automatically protect banks that comply with it from liability under state law. Nonetheless, it would be reasonable to include in federal legislation a “good faith” provision similar to that found in the Connecticut statute. The Connecticut law expressly protects a bank from liability to the judgment creditor if the bank, acting upon the good faith belief that the account received “readily identifiable” exempt benefits, failed to freeze the $1,000 protected under the statute.

The bona fide error provision of the Fair Debt Collection Practices Act (“FDPCA”) provides another possible model for language protecting banks from liability. This provision excuses a debt collector from liability under the FDPCA when it “shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.”

A similar protection—particularly to the extent that it relies on the relatively objective inquiry into whether a bank has instituted reasonable procedures for ensuring compliance—would afford banks protection without eroding their obligations under the new federal policy.

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220 See, e.g., Comment from Richard Whiting to Fed. Fin. Regulatory Agencies, supra note 168, at 3; Comment from Tenhundfeld & Shonk to Fed. Fin. Regulatory Agencies, supra note 162, at 4, 8; Comment from Jerry W. Powell, Gen. Counsel, Compass Bank, to Sec'y, Bd. of Governors of the Fed. Reserve System, Regarding Proposed Guidance on Garnishment of Exempt Federal Benefit Funds (Nov. 27, 2007) available at, http://www.federalreserve.gov/SECRS/2007/November/20071129/OP-1294/OP-1294_19_1.pdf; Comment from Daniel W. Morton to Fed. Fin. Regulatory Agencies, supra note 164, at 5 (“If there were to be any federal statute modeled after the California or Connecticut or similar statute, it would have to clearly preempt state laws that would otherwise hold the bank liable for failing to turn over funds in compliance with any such federal statute.”).

221 CONN. GEN. STAT. § 52-367b(c), (n) (2008). The Oregon bill contains a potentially broader “good faith” clause, providing that “[a] financial institution is not liable to any person for any determination made in good faith... with respect to whether amounts are subject to garnishment under this section.” Oregon S.B. 731 § 2(5). That provision incorporates the definition of “good faith” at OR. REV. STAT. § 73.0101, “honesty in fact and the observance of reasonable commercial standards of fair dealing.”


223 Id. § 1692k(c).
2. Banks Should Also Be Held Liable to Account Holders for Not Applying the Automatic Exemption

There remains, however, a potential danger in providing banks with too generous a safe harbor, particularly if it provides protection from both the judgment creditor and the account holder. Absent careful oversight, banks might rely on the safe harbor and fail to adequately review accounts for exempt funds. Given a federal policy, as articulated by this proposal, that mandates clear, standardized ACH coding, banks should have no problem ascertaining whether exempt funds are electronically deposited into an account, rendering a safe harbor practically unnecessary.

Once Congress has instituted a clear federal policy providing an automatic exemption—and the benefit agencies and Treasury Department have ensured that ACH coding clearly identifies exempt funds—banks should be held accountable for failing to comply with this law. An automatic exemption system will only be effective to the extent that banks act in accordance with its requirements. A federal policy, implemented in part by the federal financial services regulators, could ensure such compliance through monitoring and fines. Congress might also provide for a private right of action enabling individual benefit recipients to bring claims against banks that fail to comply. An effective enforcement strategy will be essential to ensuring that an automatic exemption system protects a Social Security recipient’s benefits.

F. A Final Comment on Bank Setoffs and Overdraft Protection Programs

Bank setoffs—the process through which a bank removes money from an account in order to pay off an outstanding debt the account holder has with the bank—raise additional concerns for recipients of exempt benefits. Banks have contended that because they do not need to go to court in order to setoff an account (often their actions are pursuant to an agreement signed by the account holder), the practice does not represent an "other

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legal practice” within the scope of § 407. In what is perhaps the leading case on the issue, the Tenth Circuit rejected this view, declaring:

We can see no reason why Congress would, on the one hand, choose to protect Social Security beneficiaries from creditors who utilized the judicial system, a system that is built upon principles of fairness and protection of the rights of litigants, yet, on the other hand, leave such beneficiaries exposed to creditors who devised their own extra-judicial methods of collecting debts.

In its analysis of § 407, the Tenth Circuit discussed a decision by the California Supreme Court regarding a bank’s attempt to setoff funds exempt under California law. The California decision also rejected any distinction between setoff and garnishment:

The assertion of a banker’s setoff has exactly the same effect as a third party’s levy of execution on the account—it deprives the depositor of the income which the state provided him to meet subsistence expenses, compelling the state either to give him additional money or leave him without means of physical survival.

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225 As previously discussed, although it has not spoken directly to this issue, the Supreme Court has attempted to clarify the meaning of “other legal process.” See supra note 182.

226 Tom v. First Am. Credit Union, 151 F.3d 1289, 1292 (10th Cir. 1998). The Tenth Circuit asserted that its decision in Tom was governed by the Supreme Court’s decision in Philpott v. Essex County Welfare Bd., 409 U.S. 413, 416–17 (1973) (rejecting, as a violation of § 407, New Jersey’s attempt to seize retroactive Social Security benefits under a law that required all welfare recipients to sign an agreement promising, if they were ever fiscally able to do so, that they would repay the county welfare board for any welfare payments they had received). Id. at 1291–92.

227 Kruger v. Wells Fargo Bank, 521 P.2d 441, 460–61 (Cal. 1974). A recent decision in the Eastern District of Arkansas declared that the setoff provisions in an account agreement and a separate promissory note the account holder had signed with the same bank could not lawfully apply to any Social Security benefits the account holder had not received at the time the agreements were executed. Hambrick v. First Sec. Bank, 336 F. Supp 2d 890, 893–94 (E.D. Ark. 2004). The court in Hambrick, which relied in part on Tom, emphasized that “§ 407 protects not only against legal processes, it also prohibits the transfer or assignment of future payments of Social Security benefits.” Id. at 893. Hence, any account agreement that transferred or assigned a right to future benefit payments to offset a debt was deemed in violation of § 407. Id. at 893–94.
These cases offer sound legal analysis grounded in the legislative intent that animated the establishment of these exemptions. Congress, when amending the Social Security Act to clarify and strengthen the protections provided by § 407, should ensure that these changes specify that benefit funds are also exempt from setoff by banks. As AARP and the National Senior Citizen’s Law Center both noted in their comments on the Proposed Guidelines, there is an urgent need to protect recipients from the efforts of financial institutions to seize their exempt funds. This need has perhaps grown more urgent given the financial difficulties that have recently beset the banking industry.

In addition to the problems raised by setoffs, a somewhat separate legal issue is raised by what are termed “overdraft protection loans.” This system provides account holders with short term loans, typically with fees of approximately $20 or $30, to cover overdrafts. The bank then repays itself from the account once sufficient funds (whether exempt or otherwise) are deposited. In *Lopez v. Washington Mutual Bank*, the Ninth Circuit addressed a claim that this system represented garnishment of exempt benefits through an “other legal process” prohibited by § 407. The court held that the overdraft system at issue was valid under § 407, in part because the plaintiffs voluntarily agreed to the system, rendering each deposit into the account a voluntary payment of their outstanding debt. The *Lopez* Court also tried, arguably unsuccessfully, to distinguish the decision in *Tom* on the grounds that the setoff in *Tom* applied

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230 Schultz, supra note 229.

231 *Lopez* v. Wash. Mut. Bank, 302 F.3d 900 (9th Cir. 2002).

232 Id. at 904.
to a distinct debt while the overdraft program in *Lopez* related to the functioning of the specific account into which the money was deposited.\(^{233}\)

These overdraft protection programs can divert substantial sums of exempt benefits from account holders into the hands of banks. Papers filed in a California case,\(^{234}\) which challenged the practice, stated that between 1994 and 2004, $284 million in overdraft-related fees were collected by the defendant bank from 1.1 million accounts in California receiving direct deposit Social Security payments.\(^ {235}\) The bank contends that, without such fees, it would be unable to provide these services to its account holders.\(^ {236}\) Whether or not that is the case, Congress, in establishing an automatic exemption system, should explicitly address its application to these two bank practices. Clarification would enable benefit recipients to better ensure the security of their funds and to better choose financial services that suit their needs.

**CONCLUSION**

The garnishment of federal benefits, particularly Social Security, is a national problem that demands a federal solution. Congress, which alone can consider the full scope of the issue—including the goals of federal benefits programs, the responsibilities of financial institutions, and the federalism concerns raised by conflicting state laws and garnishment procedures—is the proper institution to respond to this issue and ensure the protection of federal benefits. An automatic

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\(^{233}\) *Id.* at 906. The Ninth Circuit distinguished the Tenth Circuit’s decision in *Tom*—which had in part relied on a prior Ninth Circuit decision, *Crawford v. Gould*, 56 F.3d 1162 (9th Cir. 1995)—on the grounds that the defendant-bank in *Tom* used the Social Security deposits to satisfy a separate, pre-existing debt unrelated to the operation of the depositor’s checking account. The act of depositing the funds into the checking account was thus not an indication of an intent to pay the separate debt. Had the depositor consensually arranged an automatic payment of the loan from the account containing the Social Security funds, we suspect the result would have been different. *Lopez*, 302 F.3d at 906.

\(^{234}\) Miller v. Bank of Am., 207 P.3d 531 (Cal. 2009). In *Miller*, the plaintiffs won a substantial judgment from a California trial court in 2004, but the judgment was overturned by the court of appeals, which was subsequently affirmed by California’s Supreme Court. See *id.* at 533–36.

\(^{235}\) Schultz, *supra* note 229.

\(^{236}\) *Id.*
exemption system offers administrative simplicity and would protect benefit recipients from the hardships of existence that Social Security itself was created to avert. As the federal government encourages the use of direct deposit, saving substantial expenses in the process, it must ensure that the funds it deposits remain in the hands (and accounts) of their intended beneficiaries.
Appendix: A Comparison of Three Automatic Exemption Systems

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<tr>
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<th>California</th>
<th>Connecticut</th>
<th>New York</th>
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<tbody>
<tr>
<td>Automatic Exemption for Single Recipient of Social Security</td>
<td>$2,700 (If “one depositor is the designated payee of directly deposited social security payments”)</td>
<td>$1,000 (If electronic deposits are “readily identifiable” exempt benefits, made to account in prior 30 day period)</td>
<td>$2,500 (If direct deposit or electronic payments “reasonably identifiable as statutorily exempt payments” were made to account in prior 45 days)</td>
</tr>
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237 Author’s compilation, based on CONN. GEN. STAT. § 52-367b (2008); N.Y. C.P.L.R. LAW § 5205(1) (McKinney 2009); CAL. CIV. PROC. CODE § 704.080 (2009).
<table>
<thead>
<tr>
<th>Financial Institution's Duties after Applying Automatic Exemption</th>
<th>California</th>
<th>Connecticut</th>
<th>New York</th>
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</thead>
<tbody>
<tr>
<td>1. Freeze amount in account that exceeds automatic exemption.</td>
<td>1. Freeze amount in account that exceeds automatic exemption.</td>
<td>1. Remove funds that exceed automatic exemption and hold for 15 days from date of mailing to judgment debtor.</td>
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<td>2. Within 10 business days provide levying officer with written notice stating that account contains directly deposited benefits and noting balance of account that exceeds statutory exemption. Levying officer then promptly serves notice on creditor.</td>
<td>2. Within 10 business days provide levying officer with written notice stating that account contains directly deposited benefits and noting balance of account that exceeds statutory exemption. Levying officer then promptly serves notice on creditor.</td>
<td>Within 2 days of service of restraining notice or execution, serve the judgment debtor with the exemption notice and two exemption claim forms (by first class mail to last known address). These forms are provided to the bank by the issuer of the restraining notice.</td>
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<td>Procedure for determining whether excess money is exempt</td>
<td>Procedure for determining whether excess money is exempt</td>
<td>Procedure for determining whether excess money is exempt</td>
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<tr>
<td><strong>1.</strong> Within 5 days of notice the creditor to claim excess amount is not exempt—must file an affidavit with court.</td>
<td><strong>1.</strong> Debtor must give notice of claim of exemption to financial institution—upon receiving this bank must, within 2 days, send copy to court that issued execution.</td>
<td><strong>1.</strong> Debtor has 20 days from postmark date of forms to submit an exemption claim form. Forms are sent to bank and creditor’s attorney. (The forms also advise debtor that she may resolve claim faster by sending creditor or its attorney written proof or documents showing money is exempt.)</td>
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<td><strong>2.</strong> Hearing held: burden is on debtor to prove exemption. OR If creditor does not file affidavit, levying officer shall release account.</td>
<td><strong>2.</strong> Hearing scheduled. Funds held for 45 days from the date exemption claim form was received by bank, or until court order is entered. Exemption claim is prima facie evidence of exemption.</td>
<td><strong>2.</strong> If there is no objection by creditor, bank must release all funds claimed exempt by debtor within 8 days after postmark on envelope containing exemption claim form.</td>
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<td><strong>3.</strong> If no exemption is claimed within 15 days of notice to debtor, bank must turn funds over to serving officer and judgment.</td>
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<td>California</td>
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<td>creditor.</td>
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<td>3. If no exemption is claimed within 25 days of notice to debtor, funds remain subject to restraint. But right to exemption is not waived.</td>
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<td>4. A creditor may object to claimed exemption. Objection must include affidavit demonstrating reasonable belief that account contains non-exempt funds. Bank must hold funds for 21 days and then release them to account holder if there is no order from court.</td>
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<td>A hearing is held by court, and exemption</td>
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<td>claim form is prima facie evidence that funds are exempt, burden of proof is on creditor.</td>
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<td>Accounting for</td>
<td>First-in, First-out method: “for the purposes of determining which moneys are exempt... [the] most recently deposited as of the time the execution is served shall be deemed to be the moneys remaining in the account.”</td>
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<td>The creditor or support collection unit, after receiving from the debtor an exemption claim form with proof of exemption, must apply lowest intermediate balance principle of accounting. It then instructs bank to release exempt money.</td>
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<td>commingling (account that contains both exempt and non-exempt funds).</td>
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<td>Other Provisions</td>
<td>Provides a procedure for the judgment creditor to submit an affidavit asserting that the protected funds in the account are not in fact exempt. The judge may then order a hearing, with the burden on the creditor to establish the</td>
<td></td>
<td>If judgment-creditor objects, in bad faith, to exemption claim, the court may award to the judgment-debtor's costs, reasonable attorney fees, actual damages, and an amount not to exceed $1,000.</td>
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<td>amount of non-exempt funds.</td>
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