
Protecting Clients' Funds in Bank Accounts

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Resources

- National Consumer Law Center, *Banking and Payments Law* (4th Ed. 2009) *upcoming*, Chapter 11.
- National Consumer Law Center, *Collection Actions* (1st Ed. 2008), Chapter 12.

Involuntary Takings from Consumers' Bank Accounts

- *Garnishment*
- *Set Off*
- *Security interest*

Garnishment

- Judgment creditor – to satisfy judgment uses state authorized procedure to require bank to seize funds in the consumer's bank account
- Bank initially *freezes* the account.
- Consumer must *generally* obtain a court order to recover use of the funds
- Consumer asserts funds are exempt by law.

Set Off

- Depository Bank – holding Consumer's account
- Uses statutory, common law and/or contractual right of *set off* to pay—
 - amounts owed to that bank for another debt (e.g. a car loan or a mortgage)
 - an overdraft
 - bank fee
 - any other reason

Security Interest

- *Independent Party* -- takes a security interest in the consumer's bank account.
- When the consumer defaults on an obligation, the party seizes the bank account as its collateral.
- This method is not widely used and even less frequently enforced.

Poll 1 – Which issues appear to be creating the most problems for your clients?

- 1 – Freezing of exempt funds in bank accounts.
- 2 -- Overdraft fees taken from exempt funds in bank accounts.
- 3 – Bank's use of set-off to take exempt funds to pay other debts owed to bank
- 4 – All of the above.

Consumer Protections from Bank Account Seizures

- Some laws relate specifically to funds in bank accounts
- Other laws provide that funds received from certain sources are exempt
 - Exemption continues after funds are deposited

Issues – Exempt Funds By Source

- State or Federal laws which provide protections for funds from a particular *source*, *e.g.* –
 - wages
 - Pensions
 - Social Security payments
- Are commingled funds still traceable – commingling with --
 - non-exempt funds in consumer's bank account,
 - with the funds of another person

Issues – Funds in Bank Accounts

- State law that protects a *certain amount of funds* in a bank account, irrespective of the source of those funds?
- Does a state *wild card* exemption protect funds in the consumer's bank account?
- Is there clear law that only provides the consumer a right to recover funds after they have been frozen, or does the legal protection prevent the funds from being *frozen in the first instance*?

Bank Account Protection

- Certain amount of money in a bank account is protected, regardless of its source.
- These protections are generally self-executing (depending on statute)
- Funds can be commingled, exempt funds need not be traceable
- Bank account protections *added to other protections -- cumulative*

State Wildcard Exemptions May Apply to Bank Accounts

- Wild card exemptions not limited to funds derived from an exempt source – applies to funds from any source
- Does not matter if exempt funds are commingled or traceable.
- Funds from any source are protected, up to a certain limit.
- But wild card exemption have to be asserted so that the protection is not self-executing. Funds can be frozen until the exemption is asserted in court.

Money in Joint Accounts

- It appears in Ohio, Michigan and WV that money held in a joint account makes the entire account subject to attachment or garnishment for the debts of either of the joint account holders, irrespective of the ownership of the funds
- Issue is whether a joint tenancy by the entirety can be applicable to personal property.

Money in Joint Accounts

- Most jurisdictions rule that a creditor may seize funds only to the extent of the debtor-depositor's equitable interest in the funds.
- Courts focus: (1) the agreement between the bank and the depositors; (2) the co-depositors' respective net contributions to the account, and/or (3) statutes defining the rights in jointly held bank accounts

Money in Joint Accounts

- The Multi-Party Accounts Act (MPAA), which is applicable in some states, requires the creditor to demonstrate that the spouse who deposits the funds and who is not the debtor intended that the funds belong to the debtor

Questions

Exempt *Federal* Benefit Payments Deposited in Bank Accounts --

- Social Security benefits
- SSI benefits
- Veterans' benefits
- Federal Retirement and Railroad Retirement

Exempt *Federal* Benefit Payments Deposited in Bank Accounts

- Student loan disbursements for debts the student owes to others
- Money paid by the Federal Emergency Management Agency (FEMA) to help individual victims of disaster through the Individuals and Households Program (IHP)
- Certain other private retirement benefits and pensions.

Exempt Funds Protected

- The Social Security Act provides that Social Security and SSI benefits are not transferable or assignable and forbids “execution, levy, attachment, garnishment or other legal process” to reach benefits paid or payable to recipients
- These benefits are exempt both before and after payment to the beneficiary

Exempt Funds Protected – Exception -- *Offsets*

- To repay student loans or other debts owed to the federal government, the federal government can seize certain federal benefits by administrative offset directly from the federal paying agency, before the funds are transferred to the consumer's bank account

State Law Exemptions

- Public assistance benefits, such as from the Temporary Assistance to Needy Families program (“TANF”)
- Unemployment Compensation
- Workers Compensation
- Child Support

State Law Exemptions

- Many state laws also specifically recognize the federal exemptions from garnishment and attachment, applied to Social Security funds and other federal sources

State Law Exemptions

- Most states exempt at least a portion of benefits received under various employee retirement or pension plans
- Sometimes a state's exemption is found in the statute creating or regulating the retirement or pension plan, rather than in a general exemption law. In some states, these exemptions are also extended to tax-qualified individual retirement accounts as well as other good faith private retirement plans

Exempt Benefit Payments Deposited in Bank Accounts

- In *Porter v. Aetna Casualty & Surety Co.*, the Supreme Court held that veterans disability benefits deposited in a bank account remain exempt so long as they are readily traceable and “retain the quality as moneys,” that is, they are readily available for the day-to-day needs of the recipient and have not been converted into a “permanent investment.”

Exempt Benefit Payments Deposited in Bank Accounts

- *Porter's* rationale widely applied to other exempt benefits, to hold that exempt funds remain exempt in checking,
- Savings, or
- Certificates of Deposit,
- so long as these are “usual means of safekeeping” money used for daily living expenses.”

Effect of Commingling exempt with non-exempt funds

- Major issue with exempt funds being placed into a bank account is that they may be commingled with non-exempt funds, and creditors or banks may claim it is difficult to trace which is which.

While a minority of courts have held that the simple commingling itself may cause the exemption to be lost, these cases have not kept up with the electronic world we now live in, where banks can easily trace funds within a commingled account.

- Instead, a majority of courts continue to protect such funds

Effect of Commingling exempt with non-exempt funds

- But conversely --- some state statutes provide that specified exempt benefits which are exempt under *state law* lose their exemption if commingled.
- But, but no state applies this rule to *federal* benefits – as state law cannot affect a federal exemption

Protections for Wages Deposited in Bank Accounts

- Wages in a bank account generally protected under State law to same extent as the wages would be if garnished directly from employer
- More questionable under Federal law

No Waiver of Exemption Rights

- Banned by FTC Credit Practices Rule (16 CFR 444)
- Enforced by FTC, or
- Private remedies under state UDAP law

Protecting Federally Exempt funds Deposited in a Bank Account -- Roadmap

- Freezing versus garnishment. Temporary freezing of funds pursuant to a garnishment order will often have the same effect as a final taking (access to courts & repetitive seizures are problems)
- Exempt funds versus traceable. Just because that exempt money has been commingled with non-exempt funds only raises the issue of whether the exempt funds can be traceable.

Protecting Federally Exempt funds Deposited in a Bank Account -- Roadmap

- Federal law versus State law. If federal law establishes that certain funds are exempt, a state law procedure should not be construed to make those funds subject to garnishment. The state law and federal law should be read together so that both laws are given their intended and reasonable effect

Protecting Federally Exempt funds Deposited in a Bank Account -- Roadmap

- Who is at fault for the taking of exempt funds? The potential parties at fault include –
- The judgment creditor (often a debt collector) for either knowingly pursuing exempt funds or failing to determine the funds sought are not exempt;
- The bank for failing to follow state law – if the state law or rule indicates that the bank is required to seize *only* non-exempt funds, and the bank seizes exempt funds; and
- The state (or the state's court system itself). If the state's system for garnishing money and claiming exemptions from garnishment has the effect of allowing exempt funds to be wrongly seized pursuant to an order of garnishment, the state law – or at least the implementation of the law – may be unconstitutional.

Liberal Construction Required

- Exemption laws are to be liberally construed in favor of the debtor and the debtor's family. Courts have the equitable power to stay executions upon terms and conditions that are just.

Constitutional Test

- *Matthews v. Eldridge*, considers:
 - The competing interests involved and the effect of state action on these interests;
 - The risk of erroneous deprivation of property under the existing system and the probable value of additional or substitute procedures; and
 - The cost and administrative burden of the new procedures in comparison to their probable value.

Constitutional Analysis

- Post-freeze right to notice and a hearing on —
 - whether all or part of the frozen account is exempt
 - Question: **Does due process allow funds to be seized when the bank should know funds are exempt.**
- Current banking technological ability to easily trace deposits warrants reevaluation of precedent: freezes should violate due process.

Constitutional Analysis

- Before electronic deposit of federally exempt funds was commonplace, and pursuant to the required balancing test dictated by the seminal Supreme Court case of *Matthews v. Eldridge* – freezing of exempt assets in bank accounts was *not* unconstitutional

Constitutional Analysis

- *Mayers v. New York Cmty. Bankcorp*, [1] [1] 2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005), *later decision*, 2006 WL 2013734 (E.D.N.Y. July 18, 2006) (defendants' motion for interlocutory appeal denied).
- Subsequent cases – see Book!

Causes of Action for Improper Garnishment of Exempt Funds

- Some cases recognize a right of action under Social Security Act itself – Section 407 – creates a right that can be asserted using no other claim
- Starting with *Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962).

Causes of Action for Improper Garnishment of Exempt Funds

- Against creditors and creditors' attorneys -- Did they *knowingly* pursue exempt benefits?
- statutory claims –
 - Fair Debt Collection Practices Act
 - state UDAP statutes.
- common law claims –
 - Conversion
 - Negligence
 - Intentional infliction of emotional distress

Causes of Action for Improper Garnishment of Exempt Funds

- Against Bank – What were the instructions to bank required by state law? Were instructions deficient under state law? Did the order say “freeze only non-exempt funds?”
 - Conversion – if fees for NSF or garnishment were taken from exempt funds
 - If bank is required only to freeze non-exempt funds and freezes exempt funds – no § 1983, may be state UDAP action or state DCPA violation.
 - But if bank acts under color of state law and freeze clearly exempt funds – §1983 action.

Causes of Action for Improper Garnishment of Exempt Funds

- *Gorstein v. World Sav. Bank*, 110 Fed. Appx. 9 (9th Cir. 2004) (bank has no duty to determine whether portion of funds in account were exempt).
- *Mayers v. New York Cmty. Bancorp, Inc.*, 2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005) (recent changes in technology, i.e., electronic direct deposit of Social Security benefits and ease of identifying deposits as exempt funds, require a re-evaluation of New York procedure allowing pre-judgment freeze of bank accounts).

Causes of Action for Improper Garnishment of Exempt Funds

- *But see* Chung v. Bank of Am., 2004 WL 1938272 (Cal. Ct. App. Aug. 26, 2004) (unpublished decision) (stating that bank garnishee had duty to verify whether funds were exempt, not creditor).
- KEY – Does state law say “Only freeze exempt benefits” – then bank may be liable.
- Does state law say “Freeze everything then the consumer must come forward to protect exempt funds” = § 1983

Poll 2 – Which type of legal situation do you think you have in your state?

- 1 – The law and/or the garnishment notices tell the bank to freeze all funds, and leave it to the debtor to come in to prove and claim exemptions.
- 2 – The law and/or the garnishment notices tell the bank only to garnish *non-exempt* funds, yet the bank is freezing all funds.
- 3 – Not sure, or neither of the above.

Questions

Ways to Resolution of Problem in States

- Litigate against banks and state court regarding legality of state procedure which allows freezing of federally exempt property
- Administrative Relief on Garnishment Forms
- State Legislative Relief

State Administrative Relief

- Obtain administrative relief through state court agency which publishes garnishment forms to require forms to order garnishee to *only* freeze *non-exempt* funds.
- Done in Pennsylvania, Virginia (then undone), parts of Illinois, parts of Alabama, and other states.

Legislative Relief

- Blanket Bank Account protection such as Connecticut, California, New York
- NY – 2008 – Exempt Income Protection Act
The Exempt Income Protection Act –
 - prevents debt collectors from freezing the first \$2,500 in an account when the account contains directly deposited Social Security, Veterans Benefits, and other subsistence income protected by federal and state law.
 - same protection for earned income up to \$1,716.

Questions

Bank Set-Off

- Right of set-off not based on a security interest in a consumer deposit account but by contract, common law or the operation of a state statute.
- no “state action” and therefore no denial of due process

Federal Limitation on Bank Set-Off of Credit Card Debt

- Truth in Lending Act (TILA) card issuer can not take funds out of a deposit account to satisfy a credit card debt except under an automatic payment plan previously authorized by the cardholder in writing.

Federal Limitation on Bank Set-Off of Credit Card Debt

- Card issuer can still garnish or levy upon funds under procedures available to other creditors.
- What is restricted is the self-help remedy available only to financial institutions by reason of their relationships with their depositors

Notice Required

- None required before Set-off
- Required After Set-off
- Governed by state law

Other Requirements

- Debts must be *Mutual* -- both the bank and the customer have the dual status of being debtor and creditor.
- Debt Must Have Matured:
 - the date specified in the agreement between the parties
 - any time if the agreement is a “demand” note
 - when the consumer is in default

Exception to Maturity Requirement

- “Universal rule” is:

“when a creditor serves a bank with notice of garnishment of a debtor’s bank account, ... the bank may set off the account against the debtor’s unmatured debts owed to the bank.”

Other issues

- Accounts must be in debtor's name
- No set-off against special purpose accounts
- Debtors who are “secondarily” liable may have funds set-off – depends on state law
- Joint Accounts – depends on state law whether debts of one party can be set-off against funds in joint accounts – same rules as for garnishment – see above

Are Funds Exempt from Garnishment Also Exempt from Set-Off?

- The majority rule is that, if funds are exempt from garnishment, they are also exempt from set-off.
- Significant minority of courts, through a variety of rationales, allows set-off against these same types of funds

Exempt Funds Protected

- The Social Security Act provides that Social Security and SSI benefits are not transferable or assignable and forbids “execution, levy, attachment, garnishment or other legal process” to reach benefits paid or payable to recipients
- These benefits are exempt both before and after payment to the beneficiary

State of Washington Department of Social & Health Services v. Guardianship Estate of Keffeler -- U.S. Supreme Court

- Financial services industry argue that a *Keffeler* means the words set off is not the “other legal process” that is prohibited by Section 407.

Keffeler -- U.S. Supreme Court

- *Keffeler* should have no effect on the prohibitions of a bank's use of set-off on exempt funds – as the bank's set-off *is* just like garnishment – because it is seizing funds of another to pay itself for a debt owed. Whereas DSS in *Keffeler* was using funds to care for the recipient of the funds – there was no debt (child in foster care owes no debt for the foster care). The very similarities between garnishment and the bank's set-off should serve to distinguish set-off from the Department of Social Services' action in *Keffeler*

Set off Against Fees

- Unfortunately it is legal under 9th Circuit case of *Lopez v. Washington Mutual* for banks to engage in practice of making deliberate loans called “overdraft protection” and then offset fees against exempt funds – based on theory of waiver of §407 rights.
- Issue is up in the air regarding whether bank can set off fees and bank charges against exempt funds. Issue is pending before California Supreme Court in *Miller v. Bank of America*.
- ***But you should always ask for a waiver of fees when only source of funds is exempt benefits.***

Is there a solution? *Imperfect*

- Social Security funds can be provided using a Direct Express card. No funds can be garnished from this card. There are some fees associated with using the card, but they are minimal.
- <http://www.ssa.gov/pubs/10073.html>

Exempt Funds List Serve

- Available only to Legal Services and NACA members
- Not a lot of traffic
- To join email -- jason@shanfieldlawfirm.com
- My contact information –
 - Margot Saunders
 - National Consumer Law Center
 - margot@nclcdc.org
 - 202 452 6252 extension 104

Treasury Rules Pending

- Big deal between Treasury, OCC, OTS, FDIC, FRB, banks, & us on proposed regulation to protect exempt funds in bank accounts
- Would protect all funds in a bank account into which any exempt funds had been deposited in past 60 (?) days up to specified amount.
- Self executing
- Funds above protected amount still can be protected in court.

Poll 3 – Have you had success in getting banks and/or debt collectors to unfreeze exempt funds?

- 1 – Yes, often by simply contacting the bank and/or the debt collector and explaining that the funds are unquestionably exempt.
- 2 – Yes, but only after litigation is threatened or initiated.
- 3 – Rarely, we have to fight each garnishment and prove the exempt status each time.
- 4 – No.

NCLC Resources

