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Amendments Made to Regulation Requiring Financial Institutions

June 5, 2013

Several amendments have been made to the federal regulation issued in 2011 that protects certain directly-deposited federal benefit payments from the reach of creditors. Among other things, the amendments revise the definitions of “garnishment order” and “protected amount,” clarify that a notice does not need to be sent to an accountholder if there are no funds above the “protected amount,” and allow collection of a garnishment fee in certain limited circumstances if additional funds are deposited within five business days after conducting an account review.

These amendments take effect on June 28, 2013.

I. Background

Pursuant to a federal regulation that became effective on May 1, 2011, financial institutions served with certain forms of legal process seeking to restrain or seize funds in a customer’s deposit account (referred to as a “garnishment order” under the regulation) are required to determine whether such account contains certain directly-deposited federal benefit payments (such as Social Security), and if it does, to exempt certain funds from restraint and seizure and to notify the customer that the garnishment order has been received.

The federal benefit payments that are protected from garnishment under the regulation include Social Security benefits, SSI benefits, VA benefits, Federal Railroad retirement benefits, Federal Railroad unemployment and sickness benefits, Civil Service Retirement System benefits and Federal Employee Retirement System benefits.

The regulation requires a financial institution that receives a garnishment order to first determine if the United States or a state child support enforcement agency is the plaintiff that obtained the order. If so, the financial institution follows its customary procedures for handling the order and the requirements of the regulation will not apply. If not, the financial institution must review the account history for the prior two-month period to determine whether, during this "lookback period," one or more exempt federal benefit payments were directly deposited to the account. The financial institution may rely on the presence of certain ACH identifiers to determine whether a payment is an exempt federal benefit payment for purposes of the regulation.

The financial institution must allow the account holder to have access to a “protected amount” in the account, which is the lesser of the sum of exempt Federal payments directly deposited to the account during the

"lookback period" or the balance of the account. In addition, the financial institution generally must notify the account holder that the institution has received a garnishment order.

The federal regulation is in addition to New York requirements on protecting exempt funds in deposit accounts. The New York provisions, among other things, require financial institutions to determine if there was a direct deposit or electronic payment of funds exempt from creditors under New York law within the 45 days preceding the receipt of a restraining notice or levy. If there was such a deposit, and the account has more than $2,625, only the amount over $2,625 is subject to the restraint or levy. The New York requirements also impose additional requirements for protecting wages held in deposit accounts.

Although the federal regulation preempts any state or local law or regulation that is inconsistent with the federal regulation, the New York requirements are generally not inconsistent with the federal regulation, and financial institutions subject to New York law will generally need to comply with both the federal and New York requirements.

II. Amendments to Federal Regulation

The regulation has been amended to, among other things, slightly modify the definitions of "garnishment order" and "protected amount," clarify when a notice must be sent to an accountholder, and provide a limited opportunity for a financial institution to charge a garnishment fee when additional funds are deposited to an account. A summary of the key amendments is set forth below.

a. "Garnishment Order"

The definition of "garnishment order" has been revised to address some concerns and issues that have been raised since the regulation was initially adopted. The revised definition now specifically includes orders or levies issued by a state or a state agency or municipality (the only state agencies previously covered under the regulation were state child support enforcement agencies). The definition has also been revised to include "an order to freeze an account," which now confirms that restraining notices are considered garnishment orders.

The preamble to the amendments also clarifies an issue that had been raised by some New York financial institutions. That issue is whether a restraining notice, levy or other forms of legal process issued by a clerk of a court or by an attorney (which is typical in New York) constitutes a garnishment order. The concern had been that the definition of garnishment order states that the legal process has to be issued by a "court," thus making it unclear whether a document issued by a clerk or attorney constituted a garnishment order. The preamble confirms that restraining order, levy or other covered forms of legal process issued by a clerk of a court or an attorney acting in his or her capacity as an officer of a court does, in fact, constitute an order issued by a court.

b. "Protected Amount"

The regulation currently provides that the "protected amount" means the lesser of (i) the sum of all benefit payments posted to an account between the close of business on the beginning date of the "lookback period" and the open of business on the ending date of the "lookback period," or (ii) the balance in an account at the

open of business on the date of the account review. Some financial institutions had concerns regarding clause (ii) in that it did not take into account intraday postings of credits and debits. Accordingly, the definition of "protected amount" has been amended to capture the account balance at the time the account review is performed (as opposed to the balance at the open of business on the date of the account review).

c. Notice to Account Holder

The regulation currently requires a financial institution to send a notice to an account holder if the balance in the account on the date of the account review is above zero dollars and the institution establishes a "protected amount." This has required institutions to send notices to customers even if there are no account funds that have been frozen, such as when there are no funds in excess of the "protected amount." Because sending a notice in this situation is of little value to the account holder and in fact could cause some confusion, the regulation has been amended to only require a notice to an account holder if the balance in the account on the date of the account review is above zero dollars, the institution establishes a "protected amount," *and* there are funds in the account above the "protected amount."

d. Garnishment Fee

The regulation prohibits a financial institution from collecting a garnishment fee from the "protected amount" in an account. Despite efforts by financial institutions and trade groups to remove this prohibition, the provision was not eliminated. However, a modest change was made: if funds other than federal benefit payments are deposited into the account during the five business day period following the account review, then the institution may collect a garnishment fee from such funds during that period (but the fee may not exceed the amount of the non-benefit funds deposited).

III. Further Information

Please note that this advisory is a general overview of the amendments and is not intended as a comprehensive explanation of all aspects of the amendments. For further information regarding the amendments or the federal or New York rules protecting certain deposits from garnishment, please feel free to contact Joseph D. Simon at 516-357-3710 or via email at jsimon@cullenanddykman.com.

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- Joseph D. Simon