Consumer Finance Monitor (Season 3, Episode 21): CARES Act Economic Impact Payments for Individuals and Paycheck Protection Program Loans for Small Businesses: Are They Subject to Garnishment or Setoff?

Speakers: Alan Kaplinsky and Lori Sommerfield

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers and the industry. I'm Alan Kaplinsky, and I chair our consumer financial services group at Ballard Spahr. And I'm very pleased to moderate our podcast today. For those of you who want even more information, don't forget about our blog, which is also called consumerfinancemonitor.com. We've hosted the blog since 2011, at the time when the Consumer Financial Protection Bureau was stood up. So there is a wealth of relevant information on the blog. We also regularly host webinars on subjects of interest to those in the industry. So you definitely should subscribe to our blog, if you don't already have a subscription, and get on our list for our webinars. And you can do that by going to our website, ballardspahr.com.

Alan Kaplinsky:

If you like our podcast, of course, let us know about it and leave us a review on Apple Podcasts, Google Play, Spotify or whatever your favorite podcast platform might be. So today I am very pleased to be joined by my colleague, Lori Sommerfield. Lori is relatively new to Ballard Spahr and to our consumer financial services group. And although she is relatively new to us, she's not new to the consumer financial services industry. She's been involved in the industry for a lengthy period of time. She joined us in mid-February of this year. Most recently, Lori served as deputy general counsel for consumer banking at TCF Bank, a regional bank based out of Minneapolis. She's also practiced law in the federal government. She's been in-house and in a private practice. Lori knows a lot about the consumer finance in general, but has a particular focus on Fair and Responsible Lending and the Americans with Disabilities Act.

Alan Kaplinsky:

She also in connection with the COVID-19 pandemic, she has really been instrumental in helping us launch what I would call the consumer finance portion of the COVID-19 resources that we make available to our clients and our friends. The topic we're going to be talking about today is a very hot topic with respect to COVID-19 and particularly as it applies to the consumer finance and the small business lending area. And that is we're going to talk about whether certain types of payments that have been received, and that will be received in the future by individuals and small businesses under the recently enacted CARES Act in an earlier statute, whether or not they're subject to garnishment by a third party creditor, or whether they might be subject to set off by the bank. That is if you owe the bank money and funds are wired into your account, can the bank before giving you access to the funds, deduct whatever you may owe to the bank?

Alan Kaplinsky:

So there are roughly two kinds of payments that we're talking about here. First of all, we're talking about what's called the federal stimulus payments to individuals. They're often known as Economic Impact Payments. And these are payments generally of $1,200 which were given to people who did not report more than a certain amount of income on their most recent tax return. And the second thing we're talking about, or we'll talk about are loan proceeds under the SBA Payment Protection

Program. This is a very popular program, Congress originally funded it with $349 billion. The money was exhausted within a couple of weeks, and Congress had to go back and had to reauthorize additional funding. So Lori, welcome to our podcast.

Lori Sommerfield:

Thank you so much, Alan. I'm delighted to be here today with you.

Alan Kaplinsky:

Great. So Lori, I've already given our listeners some background on the issue, but may you probably want to provide a little more detail or a little more color?

Lori Sommerfield:

Sure, Alan. I'd be happy to do so. Well, let me fill you in a bit more on this issue. So as Alan mentioned, the CARES Act was enacted on March 27th. And unfortunately it's silent on the issue of whether either of these Economic Impact Payments, which I'm going to call EIPs for short during our discussion today, or whether PPP loan proceeds can be garnished by creditors. Specifically, the CARES Act doesn't exempt either EIP or PPP loan proceeds from garnishment, or treat them as funds that are basically federally protected benefit payments that would be protected from garnishment. So the upshot is that's creating problems for bank customers who are already struggling financially, as we all know. And in some cases, those, the depositors may already have deposit accounts that are subject to state garnishment orders.

Lori Sommerfield:

It's also creating frustration for creditors, as well as debt collectors, who would like clarity on this issue. But most importantly, banks are caught in the middle of it. They don't want to garnish their depositor's accounts because they know their customers need these funds urgently. And they also don't want to garnish accounts because of the reputational risk that is involved in garnishing funds when people are already a bit down on their luck financially. But yet banks are also required to obey state court garnishment orders, unless there might be some state guidance that's been issued, that directs them to do otherwise.

Alan Kaplinsky:

So Lori, let me back up a little bit. It's very strange what Congress did here, because am I right? That social security benefits, other types of federal benefits in all those situations, those proceeds are payments that are being made by the federal government and often by state governments are not subject to garnishment. Am I right about that? Or am I off base on that?

Lori Sommerfield:

Nope, you are absolutely correct, Alan.

Alan Kaplinsky:

Why in the world? To me it's almost unfathomable that Congress overlooked such an important issue. I know there was a hurry to get these laws enacted, but certainly after the first law was enacted and people looked at it, they noticed that there was nothing in there pertained to garnishment. And I'm sure a lot of people complained about it, right?

Lori Sommerfield:

Absolutely.

Alan Kaplinsky:

Well, who dropped the ball? I can ask. It's my question. Somebody did.

Lori Sommerfield:

Well, I guess if I had to point a finger, I would say I would point it at Congress themselves because they were in charge of drafting this legislation, right?

Alan Kaplinsky:

Right.

Lori Sommerfield:

So many have wondered whether it was simply a legislative drafting oversight by Congress or whether they intentionally chose not to confer the status of a protected federal benefit payment on these EIPs. Like it's done for other federal statutes that you just mentioned, like Social Security and VA payments and the like. But the odd thing about it is that this section of the CARES Act, which is section 2201 very specifically carves out other types of payments from offset. So for example, EIPs can't be offset for certain purposes like past due federal and state income tax debt or administrative debts that are owed to federal agencies. But EIP funds can still be used to offset past due child support. And obviously that's for public policy reasons. So the legislation was very specific in a certain sense about the types of ways in which EIPs could be or could not be offset. But yet, as you said, this is a huge omission in terms of permitting private creditors to garnish EIPs. So there's a little bit of intrigue about that, that I can explain if you'd like between Treasury's authority under the act and Congress not acting.

Alan Kaplinsky:

I'd like to get to that, because what I'm wondering about is whether this is a problem that could be rectified by Treasury issuing a regulation, or maybe something even less formal than that. And if it can be done in that way, why in the world haven't they done it?

Lori Sommerfield:

Well, you are spot on that under the CARES Act, Treasury has been given appropriate authority to remedy this issue. Section 2201(a) of the CARES Act gives Treasury the authority to either issue informal guidance or something like an emergency rule, which would typically be as you know, an interim rulemaking to clarify that EIPs are not subject to garnishment. And in fact, Treasury secretary Mnuchin has actually been aware of this issue since April 1st. Apparently Democratic member of Congress named Sherrod Brown from Ohio called secretary Mnuchin and made him aware of the issue. So Treasury has had plenty of opportunity to act on this, but what we are hearing is that Treasury believes that the authority that is conferred to them in the CARES Act is insufficient for them to act on it, either to issue guidance or an interim role. So, as a result falls to Congress now to go back and do a technical amendment to the CARES Act to clarify the issue, but to date that hasn't happened either.

Alan Kaplinsky:

You think Treasury is misreading the CARES Act, that the way you read the language, it's got the authority already. What exactly does the statute say with respect to the authority of the Treasury to issue a reg or a guidance? I'm curious why they don't think they've got the authority.

Lori Sommerfield:

I am too, because the authority that is conferred under section 2201(a) of the CARES Act is very broad. It basically gives the secretary of Treasury authority to issue either guidance or rule that would implement that section regarding EIPs. So I think what Treasury is looking for Alan is some very explicit authority that would say that EIPs should be treated or will be treated as a federally protected benefit payment. Language that's akin to what is found in some of these other statutes, like the Social Security Act.

Alan Kaplinsky:

Okay. I can see their point, particularly in light of the fact that they did address in the act, the fact that certain amounts that you might owe to the federal government, that, that couldn't be offset. If you owed money to the IRS, nevertheless, you would receive your economic stimulus payment. So there likely will be additional legislation. Do you think that it will get taken care of? Or is it still anybody's guess?

Lori Sommerfield:

Well, based on a recent discussion I had with the banking trade association group, their thought is that the legislation or the technical amendment will not occur, unless there is additional legislation that actually confers more EIP payments on Americans. So let's say that there's another second round of these federal stimulus checks or EIPs, then Congress would probably insert some technical amendment then saying these should be treated as protected federal benefit payments.

Alan Kaplinsky:

Yeah, of course if Congress does that, it's not going to help the people who already received the payments that were made pursuant to the earlier laws and have already had it garnished.

Lori Sommerfield:

It's correct.

Alan Kaplinsky:

Yeah. The cow is out of the barn by that time, I guess they could deal with it with the respect to future payments. But let me ask you this. We're focused very much on the federal government, then the fact that there's nothing in the federal law that specifically says you can't garnish, but what about the states? Some of the States that have been active in this area might not right.

Lori Sommerfield:

That is correct, Alan. So basically what's happened is that states have leaped into this federal void because there hasn't been either guidance issued by Treasury or a legislative fix by Congress. So we've seen various actors at the state level issuing directives to try to prohibit garnishment of EIPs. So, for example, we've seen state AG opinions. We've seen executive orders from governors. We've seen orders from the state supreme court. That are taking different tactics in the way that they go about trying to preclude garnishment of EIPs.

Alan Kaplinsky:

So do you have any rough idea of how many states have acted?

Lori Sommerfield:

Yes, actually, by my count at this stage, we have 12 states that have issued directives either in the form of guidance or orders that prohibit garnishment of EIPs.

Alan Kaplinsky:

Okay.

Lori Sommerfield:

I might just add Alan, that some of these directives are pretty aggressive. For example, the New York AG's guidance that basically declares any attempt to garnish EIPs as an unfair or deceptive after practice. And the New York AG has said that she would go after any violators of that guidance very aggressively. Most recently here in Minnesota, since I'm part of Ballard's Minneapolis office, the Minnesota governor, Tim Walz issued an executive order that even imposes penalties up to $25,000 per violation. So, some of these state actors are taking this issue very seriously and going to great lengths to protect their citizens deposits that containing EIPs.

Alan Kaplinsky:

Yeah. And so the penalties, would they be on the bank or the person who's trying to garnish or both?

Lori Sommerfield:

It depends on the state. So for example, the Minnesota governor's executive order said that it applies to any person who violates the garnishment prohibition. So I think that could be construed broadly depending on how they want to enforce that directive. It's [crosstalk 00:18:30] either way.

Alan Kaplinsky:

So I hear what you're saying. I'm going to do a little role playing with you now, Lori, I just called you up on your potentially important client. I'm a general counsel of a very large bank in the country. And I say, we've received a lot of Economic Impact Payments. We're receiving proceeds of SBA Paycheck Protection Program loans, we're making those loans, putting the funds in bank accounts. What do you suggest that our bank do Lori? We've got to write a set off for some customers. We've got a garnishment orders that we receive every day. Do we honor them? Clearly, we don't want to look bad. We don't want to see a bad article in the paper. We don't want any headline risks, and we don't want our reputation to be tarnished, but I'll also tell you, we don't want to get caught in the middle where we end up going out of pocket because we made a mistake. So what do we do?

Lori Sommerfield:

Yeah. Well, there's three separate issues in there, right? So we're talking about EIPs. We're talking about Paycheck Protection Program funds, and then also the right of offset. So they're all a little bit different Alan. So first of all, on the EIP issue, first of all, I think the overriding concept should be that banks still have to abide by these state garnishment orders, unless there's a state directive that allows them to actually refrain from allowing the garnishment to proceed, and they can protect those EIP funds of their customer. So if there is a state directive, they need to analyze that directive and determine, first of all, does the issuing authority site to appropriate authority that allows him or her to actually issue it?

Lori Sommerfield:

That's the threshold issue. The second concept is, is the legal argument that is laid out, whether it's by a state AG or a governor or anyone else, is it rationally based on state law in a way that it actually has a nexus with the CARES Act that makes sense? That would allow the bank to rely on the state directive. If so, then I think the bank can go ahead and rely on that state directive to protect their customers funds. So that's an issue on EIPs. With regard to the PPP loan proceeds, that's a little bit different. And if you don't mind, if I could just explain a little bit more-

Alan Kaplinsky:

Sure.

Lori Sommerfield:

So let me just go back to EIPs for a moment. I think we all know the purpose of these federal stimulus payments, right? They're intended to protect people and financially support them who are struggling. And the intention is that it's to provide for basic life necessities, like food, medicine, shelter payments, mortgages, rent payments, that's all very implied, but it's actually not explicitly stated in the CARES Act. But if you conversely look at the Paycheck Protection Program section of the CARES Act. That very specifically lays out a clear purpose for those loan proceeds. So section 1102 of the CARES Act expressly specifies that these PPP loan proceeds have to be used chiefly for payroll costs, actually up to 75% and other business related expenses in order to help a business just stay afloat.

Lori Sommerfield:

So there's a conflict then between the federal CARES Act, which requires that the PPP loan proceeds be spent on payroll and these other business costs versus state law that would require that the funds be garnished by a creditor. So that's where the conflict comes in. And as you know, whenever there's a conflict between federal and state law, it's necessary to conduct a federal preemption analysis. So having actually assisted some clients with this issue, we think there's a pretty strong argument that the PPP section of the CARES Act, which as I said, specifies, this very clear purpose for use of the loan proceeds doesn't include garnishment on the list. So as a result in our view, it's pretty likely that the CARES Act preempts state garnishment laws. So banks would have a right to actually say, Nope, we're going to protect those loan proceeds for the small business owner.

Alan Kaplinsky:

Well, just to clarify, that preemption is a preemption created potentially by the CARES Act, but not by the National Bank Act. I assume-

Lori Sommerfield:

That is correct.

Alan Kaplinsky:

Yeah. National Bank Act preemption comes into play when you're talking about a potential right of set-off, whether a state could preclude a national bank from setting off. Well, let me push back just a little on what you said. Is it a 100%... I recognize that the CARES Act tells you how you have to use the proceeds, but might you argue that what Congress is referring to is how the borrower can use this, whatever proceeds it or he, or she receives? And that if the proceeds are reduced because of a valid garnishment under state law, you can really reconcile what's in the CARES Act with state law. So it's not necessarily what you would call conflict preemption. Can I make that argument?

Lori Sommerfield:

Yeah.

Alan Kaplinsky:

Or am I off base?

Lori Sommerfield:

I see what you're saying. I think that's actually splitting hairs though, because again, why would Congress allocate these PPP loan proceeds to a small business owner and then say, well, we're going to let a private creditor take them away from you so that they're not actually available to support your business.

Alan Kaplinsky:

Right.

Lori Sommerfield:

So I think if you look at this from more of a public policy perspective.

Alan Kaplinsky:

Right.

Lori Sommerfield:

I don't think that's the right outcome.

Alan Kaplinsky:

Yeah. Okay. What about now the right of settle off? Banks very often either have a common law right of settle off, or it could be statutory it in a particular state, I'm not sure there's anything in the national bank act dealing with the writer's set off. Why don't you explain for our listeners what that right is and how that relates to the stimulus payments and or the proceeds of SBA loan?

Lori Sommerfield:

Sure Alan. So by way of background, as you just said, Alan, this right of offset arises by virtue of state law typically, either as you said, common law or statutory, and under that framework, banks are permitted to offset amounts that are owed by delinquent borrowers. If they have outstanding loan payments or deficiency balances on checking accounts, let's say for example, from overdrafts. And that might also include fees for example, but banks are basically allowed to offset those amounts with any new funds that are deposited into a customer's bank account. So this is something that is usually established by contract law. So when you open a deposit account at the bank, you sign a contract with the bank. When you enter into a loan agreement with a financial institution, it's the same concept.

Lori Sommerfield:

So you're basically contracting with the bank as a matter of state law that they will have the right among other things to offset any due and owing amounts based on any funds that you hold in a deposit account at the same institution. So unfortunately under the CARES Act and just like the EIP and the PPP loan proceed issue, the ability of private parties, or I should say the right of offset is also an issue that isn't addressed in the CARES Act. And in my view, I think the reason for that is that Congress probably realized that they couldn't override existing contracts between banks and their customers. So they didn't attempt to address that issue in the CARES Act.

Alan Kaplinsky:

So are you saying then that banks have the legal right and here we're talking about any kind of a bank, national bank, state bank, they've got a contract right to offset, which is generally recognized under a federal and state law. And technically, they can do that with an economic stimulus payment, but probably not such a good thing to see Britain in the paper about that. Right. That's what you want to read about.

Lori Sommerfield:

That's correct. And it's been in the paper to a certain extent about some banks that have chosen to go down that path because they have the right to, because the CARES Act doesn't prohibit banks from exercising the right of offset. But to your point, I think Alan is the reputational risk is pretty great. So most of the largest banks in the country have come out proactively and said, they're going to refrain from engaging in offset. And some other banks have decided to follow course.

Alan Kaplinsky:

Right. Right. Well, particularly for the economic stimulus payments, but probably also for the proceeds of an SBA loan, although I would think that it if a customer is applying for an SBA loan and the customer owes the bank money already, the customer is not going to be very happy if he, she, or it doesn't receive the full proceeds of the loan because the bank has exercised the right of offset. I guess it might be okay from a public relations standpoint, if the bank disclosed ahead of time to the loan applicant, that it's not going to provide a 100% of the proceeds.

Lori Sommerfield:

Right. That would be a very good idea for banks that are choosing to continue to exercise the right of offset is to engage in those proactive communications with applicants.

Alan Kaplinsky:

Sure. Okay. So Lori, we've really drawn to the pretty much the end of our podcast today, but before I wrap things up, is there anything else that you would like to share with our listeners?

Lori Sommerfield:

Yes, Alan, I actually have a few words of advice, I think in terms of helping banks navigate these issues. So just some suggestions for a few mitigation measures that you might consider as you're working your way through these issues. And the first concept just follows on to what you and I were just talking about, Alan, which is that banks should engage in proactive communications with their account holders and their PPP loan applicants. So if we're talking about the EIP issue in particular, if you've got an account holder who's currently subject to a garnishment order, or any account holder who becomes subject to garnishment during this COVID-19 crisis, it's really important to make sure that you're getting out in front of it, communicating with them proactively and underscoring the fact that garnishment by creditors, isn't prohibited by the CARES Act and the bank has to follow the law, unless there's a state directive that allows them to actually protect the funds for their customer.

Lori Sommerfield:

So, be very transparent with customers and with loan apps about that. I'd also recommend a similar approach for offset, proactive communications, again, advising the customer base that the bank intends to exercise the right of offset. And the fact that the CARES Act doesn't prohibit it because it's a matter of contract between the bank and its customers as a matter of law. I'd also advise our banking clients to stay abreast of any new state law developments, because these are occurring almost daily, evaluate any state level orders or guidance or directives that might preclude garnishment by creditors or offset by the bank in your market areas and determine whether it applies to your operations. And then if so, what your policy going to be. I think it's also a good idea to closely monitor customer complaints for garnishment and offset issues, and then quickly respond to them consistent with whatever policy the bank develops. And then finally, I think last thing to be on the lookout for is any notification from a garnish shore that might suspend garnishment actions.

Alan Kaplinsky:

Okay. Well, Lori, thank you very much for being our guests today on our podcast show.

Lori Sommerfield:

My pleasure, Alan.

Alan Kaplinsky:

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