

Consumer Finance Monitor (Season 5, Episode 30): Takeaways for Banks from the CFPB's Recent Consent Order on Garnishment Orders

Speakers: Alan Kaplinsky, Michael Gordon, and Jessica Simon

Alan Kaplinsky:

Welcome to Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services. I'm Alan Kaplinsky and I'm your host today. I am senior counsel at Ballard Spahr. I'm formally the chair of the Consumer Financial Services group and was the chair for about 25 years.

Alan Kaplinsky:

We're going to be talking about an agency that we can't seem to get away from. We have done a lot of podcasts about the Consumer Financial Protection Bureau, referred to as the CFPB. Today, we're going to talk about an order that was issued in May of this year by the CFPB against a large bank for conduct that was related to bank account garnishment and their account agreements. This was the first time the CFPB had ever gone after a bank because the CFPB believed that they were improperly honoring garnishment orders that were being entered by courts and they were turning over funds in consumers' deposit accounts and charging fees. The CFPB did not like what they were doing.

Alan Kaplinsky:

So I have put together a program today where I have two of our guests are from my law firm, Ballard Spahr. So without further ado, let me introduce our guests today. First of all, Jessica Simon. Jessica's practice focuses on a wide range of complex and commercial litigation and insolvency matters during all stages of proceedings in state, federal and bankruptcy courts, as well as on appeal, particularly concerning distress debt. She has substantial experience representing secured and unsecured creditors, including financial institutions and asset managers in restructuring liquidations, collateral receiverships, and collateral recovery among other things.

Alan Kaplinsky:

And then I'd like to introduce Michael Gordon. Mike is a partner in the Consumer Financial Services group, and he is a former senior official at the CFPB who has more than two decades of experience in consumer financial services law. Over his career, he served in private practice as a senior federal regulator and as the FinTech general counsel. And when he was at the CFPB he had a very senior position, counseling the then director of the CFPB Richard Cordray. Today, he is now a partner at our firm and he helps banks and non-bank financial services companies with regulatory compliance, examinations and enforcement defense. So first of all, very warm welcome to you, Jessica and to you, Mike.

Michael Gordon:

Thank you. I'm looking forward to discussing this topic because I think this is going to be a real interesting one for our audience.

Alan Kaplinsky:

I agree because I have a feeling that a lot of the banks probably have practices that are very similar to what this large bank was doing.

Michael Gordon:

Yeah. In fact, I would say this is one of those areas where the bureau, and they've done this before, they come in to an area where banks or other service providers have kind of well established practices. And then they upset kind of the traditional thinking about how those practices should work and cause a lot of uncertainty. And I think that's what's happened here.

Alan Kaplinsky:

Right. Yeah. So, okay. I've got a lot of questions for both of you. I'm going to start first with you, Mike. I'm wondering if you could tell our listeners, what did the CFPB do recently in regard to garnishment procedures?

Michael Gordon:

It was an enforcement action in May and it resulted in a consent order that was announced with a large national bank. The remedies included a \$10 million civil money penalty as well as the refund of certain fees associated with the garnishment process. And what the bureau was focused on was whether consumers were getting the benefit of the correct laws and protections surrounding the garnishment of their bank account and funds they're in. Banks are in the middle in this process. Typically, if there's a consumer debt and a judgment, the court that issues the judgment will then issue a garnishment order if appropriate to seek to attach funds in a bank account for the creditor to address the outstanding judgment. So the funds that are being attached are not the bank's funds, but they're the custodian. So they sit in the middle between a creditor trying to seize funds and a debtor who is their customer whose funds are in the depository account.

Michael Gordon:

This process is largely a state law process. And because we're talking about judgements that typically originate from state law matters and there are state procedures that govern how garnishment orders are supposed to be issued and enforced, there's some federal law on this topic but it's primarily a state law issue. And what the bank allegedly did wrong. According to the bureau was two things. One was how they actually handled garnishments, and I'll explain that in a minute. And the second was how they tried to address the liability for the garnishment process through a waiver in their account opening agreement.

Michael Gordon:

So the practice itself, it's helpful to think about it this way. The first question you need to ask is where does the account live because the state law, at least in some of these states, is going to look to where the account resides to answer the question which state law should apply to the process. In today's day and age, that's not always an easy question to answer if you envision for example an online account opening. It used to be quite obvious, you'd walk into a branch, open an account, you live near the branch, you make your deposits at the branch. There's not really a question about where that account lives, but-

Alan Kaplinsky:

Well, there could be if the person then moved, right? Out of state.

Michael Gordon:

Right. Right. Exactly. So that's a complication that would happen traditionally, but there seems like more complications today. And in fact, I expect this area of the law to evolve as more courts have to grapple with the notion of accounts that people are creating on their iPhone, wherever they happen to be. And so as with all state law questions, there's no uniform answer here. It is a state by state analysis of questions like where the account lives and what laws should apply.

Michael Gordon:

So what the bureau took issue with is the wrong state law being applied to the detriment or potential detriment of the consumer. Why does the state law matter? Well, in one important respect, there are limitations that state laws can place on garnishment, such as statutory minimum amounts that you must leave untouched within a bank account if you're going to garnish funds, or types of benefits that flow into that account that can't be touched because their government benefits and

state laws may have determined those to be not garnishable to a certain extent. There are also some federal guidance to that effect where there are federal restrictions on federal benefits being garnished. But these state laws can vary and therefore the level of protection can vary.

Michael Gordon:

The bureau's concern with this bank's practices at its most basic level was that the consumer was not always getting the benefit of the state law of protections it should get and that the bank was processing garnishments inappropriately. The situation that's more specifically that the bureau was concerned about was a situation where there's more than one state involved. If all the relevant contacts, bank accounts, residences, judgement, all occur in the same state, it's pretty obvious which state law is going to apply. But there's a choice of law question when there are multiple states involved. So if account exists in state A but there was a judgment in state B, this would be what the bureau referred to as an out-of-state garnishment, because you have an order from state B trying to attach funds in state A.

Michael Gordon:

It was in those circumstances for a small number of states that the bureau felt like the bank was not being careful enough to apply the correct state law to these questions. So that in short was the objection to the practices. With respect to the account agreement itself, it contained a waiver agreement or a waiver provision that purported to waive the customer's rights to contest garnishment once it's in process and to waive the bank's liability for improper handling of garnishments. The bureau found that provision itself to be file of UDAP, specifically I think it was both unfair and deceptive because it led consumers to believe that they weren't entitled to certain state law exemptions that in some cases were not waivable to begin with. So that's in short what the bureau tried to accomplish with its order. They took issue with both the practices when there are out-of-state garnishments and how the account agreement treated the liability for those garnishments.

Alan Kaplinsky:

Yeah. So Jessica, Mike referred to certain states that have these exemptions that the CFPB thought that this large bank should have been sensitive to and should not have garnished the accounts to the extent that the judgment creditor wanted to. Which states are we talking about? Are there a lot of states involved here?

Jessica Simon:

Well, first the bureau defined a restriction state as a state that prohibits or otherwise restricts garnishments of out-of-state accounts. So the focus was on garnishing funds from out-of-state accounts, not in-state accounts. They didn't clarify the legal authority for determining whether a state is a restricted state. They did, however, define five states as restriction states. That's Alabama, Arizona before August 2019, California, Florida post August 2014, and Oregon. Now, one of those states, the bureau no longer views to be a restriction state, and that's Arizona. We believe that's the case because in around August 2019, the Arizona legislature appears to have added a subpart to its garnishment statute which now appears to allow service on a financial institution by certified mail at the institution's regular place of business or upon its statutory agent. We haven't found or seen any post 2019 cases that addressed this revision. And prior case law that we had reviewed seemed to follow the procedure that most of the other restriction states follow.

Jessica Simon:

Nonetheless, the bureau no longer believes that Arizona's a restriction state. And it seems reasonable to believe that the Arizona courts at some point may reverse their prior rulings to become in accordance with the new Arizona subpart. So right now we're essentially dealing with four states. There may be others out there, but again, the bureau didn't clarify or didn't provide any legal authority that would identify other restriction states. But we do know that there are at least four states that currently are considered to be restriction states. And those are Alabama, California, Florida, and Oregon at this time.

Michael Gordon:

I just wanted to add, the bureau focused on these states, as Jessica said, as states that have some limitation on the service of a garnishment order that would originate in that state. So there's a judgment in one of those four states seeking to garnish funds in another state. That state law has something to say about that process. And other states, presumably the bureau's view is they don't have the similar limitations on process that these four states do. The limitation on process in particular, and we know this from the relief provisions and other language in the order, the process that the bureau thinks is appropriate in those cases is if you are in receipt as a bank of a garnishment order in this kind of out-of-state context for these particular states. You can't just go ahead and process the order. You need to respond saying there are no garnishable funds within the state and wait. And perhaps the order then gets domesticated in the second state and issued from the second state.

Michael Gordon:

At that point, if the state, in which the funds reside, if an authority there has issued the garnishment order, then you're okay to proceed. But what the bureau took issue with was the bank just go ahead and freezing and then garnishing funds in these particular states without additional process in the state where the account resides.

Alan Kaplinsky:

Yeah. So Jessica, another question I'd like your thoughts about is how does the consent order affect a financial institution's garnishment practices?

Jessica Simon:

Yes, Alan. So this is sort of what Mike was just discussing in terms of how it affects the process to determine whether a writ is validly issued from a state, which in turn affects a financial institution's compliance with it. So as Mike mentioned, there is what is the issuing state, which is the state from which a garnishment writ issues. And then there might be a receiving state or what we sometimes call sister states in the world of domestication that is the other state where property is held and traditionally it might be where real property is held, but it also can be where an account is located or maintained. So those are the two different states that we're dealing with here.

Jessica Simon:

As an initial matter, so case law concerning garnishment practices in the restriction states it's not altogether clear. A lot of this is the law is undeveloped. But some states such as Florida for instance, has more developed laws than others such as Oregon, which has very little law in this matter. And in most of the restriction states, there does appear to be a consensus that the law of the state that issues a writ governs the procedures that a judgment creditor must follow to have a writ validly issue to garnish funds of out-of-state accounts. So for example, if a writ issues from Florida, then Florida law would govern this process. So again, the law in most of the restriction states including Alabama, California and Florida, appears to be clearer than others such as Oregon. But we do know that once a writ is validly issued from a court and once that determination is made, the financial institution then has to look at the appropriate federal and state exemption laws in which law to apply.

Jessica Simon:

I know that Mike will discuss that a little bit later because that's a different and separate inquiry that has to be made. But the main point, Michael will chime in in a moment, but I was just going to say that the main point here is that the bureau suggests that for out-of-state garnishments that originate from a restriction state, that a one size fits all approach may not work and that may have been part of the issue that they were dealing with in the consent order. The approach needs to be tailored depending on the procedural requirements of the issuing state. And the bureau also appears to have an expectation that the financial institutions have done some sort of due diligence to determine whether a writ is validly issued and whether it must comply with it.

Michael Gordon:

I was just going to add that the bank in question in this consent order was aware of these differences in state law, at least to some extent, but the bureau took a very strict line against them. They noted that the bank indeed had in place processes for dealing with these special states, but that they weren't consistently applying those procedures. And so for banks and credit unions and other institutions that are custodians of accounts and therefore recipients of these garnishment risks, this really comes down to a lot of practical blocking and tackling on your procedures for accepting, identifying the validity of, and responding to these garnishment orders. And it is a state by state process that's required by the bureau here and it's not so straightforward.

Alan Kaplinsky:

Yeah. Well, let me ask. I mean, is it possible given the situation that you've described for a bank to, I guess, write a manual, a detailed manual in which they tell whoever's in the garnishment area of the bank what they should be doing? I mean, whoever handles garnishments, they're not lawyers I'm sure. You can't leave things up to their discretion. They've got to be able to look at some kind of a manual and say, "Okay, person lives in states such and such. Account was opened in such and such a place. Customer lives in such a state. Yes, you can honor the garnishment. No, you can't honor the garnishment." I mean, am I right?

Michael Gordon:

That's exactly right. This is an administrative process that has to be practical. And that creates a challenge because as with many processes in the consumer finance world, the bureau has very little tolerance for any mistakes. But ensuring 100% accuracy can be quite expensive in terms of the administrative resources you need to accomplish that. And institutions often need to balance their administrative burden with their compliance burdens in a way that makes sense for the institution. But here, the bureau was quite clear that as I mentioned, the bank was not blind to these obligations but didn't perfectly execute them or consistently execute them. And so I look at it as a balancing of risk in a sense, because as I said, there's the practical concerns always sort of have some kind of balance with compliance concerns.

Michael Gordon:

But in this case, there's an additional balancing or series of sort of countervailing risks. What I mean by that is because of the unique position that banks play in the middle of the garnishment process, it's not their money. So on the one hand they may want to be protected with their customers and the bureau may set high expectations for how you do that. On the other hand however, if they're too slow to attach funds and garnish them and according to a state judge's order, ultimately if they are deemed by that court to have not acted appropriately in the face of that order, they themselves, the bank, can be held liable for the funds that are garnished. And so it could come out of the bank's pocket rather than the consumer's pocket if they're deemed to have not properly responded to a garnishment order. So there's a balancing of risk there as well of regulatory risk perhaps on the one hand and the risk that you could be held liable for failure to garnish.

Alan Kaplinsky:

So while this consent order only applied to one particular bank that we've been inundated with calls and inquiries from our other banking clients wanting to know does it apply to them and of course a consent order only literally applies to the bank that signed the consent order, but we certainly can learn a lot from this consent order of what the CFPB thinks that all banks should do. So I assume that the work that you have to do, that we as lawyers have to do with the other banks is to look at their manual, see what they're doing now, and probably in a number of instances change them, right?

Michael Gordon:

Yeah, that's right. And to answer your earlier question which I may have not answered directly, yes, many institutions do have the kind of manual that you envisioned to guide the process for those who have to handle these garnishment orders. This consent order has caused a number of our clients to take a second look at their own processes and the state laws that should drive those processes to make sure that those procedures are compliant.

Alan Kaplinsky:

Right. Right. So let's move on to another aspect of it. Jessica, this whole issue of where's an account domicile, how do you determine that?

Jessica Simon:

Yes, Alan. So this is actually one of the more complicated areas. And kind of getting back to your point about having a clear manual, although that is an ideal situation for many banking institutions, the consent order really did throw that into flux and make it a little difficult sometimes to create a clear avenue on how to process garnishments. And part of the reason for that is that there's an overarching question about where an account is domiciled. And Mike mentioned that early on, that is part of a crux of the consent order. The answer to this question is not entirely clear as this is an area of the law that's constantly evolving and changing in light of modern technological changes and processes and the opening of online accounts. We no longer have a situation where a consumer always goes to a local branch to open an account where the consumer is domiciled. Instead the location maybe fluid, particularly if in account is opened online. State law also varies on this issue.

Jessica Simon:

Nonetheless, there is some guidance in the restriction states that suggests that those states may follow a traditional view that an account is domiciled where it's located or maintained. If an account is maintained at a local branch, then the domicile maybe where a branch is located. But again, that gets us to the question about what happens if an account is open online. In this situation, some courts have suggested that a court may look to various factors to determine where an account is domiciled if an account is online such as where deposits made, where is maybe someone physically sitting when they open the account online, where is the address that they include on their application. Such factors like that. But again, there aren't conclusive answers in the law right now. So over time, as more accounts are opened online, courts may begin to address this issue more. But for now the answer requires an evaluation of state law. And in some cases a financial institution's account agreement which may define where an account lives, it may not. But those are helpful considerations to determine where the domicile of an account is.

Michael Gordon:

And I would just add that in light of that complexity and in some cases uncertainty, it really is important for financial institutions to carefully consider each of the state laws that they're operating under that could be relevant to the garnishment decision. And each institution is going to have to come up with their own risk balance to come up with an administrative process that is compliant. And it may not look exactly the same for every institution.

Alan Kaplinsky:

Right, right. So Jessica, does the bureau provide any guidance in responding to writs of garnishment if the writ is issued from one of these restriction states?

Jessica Simon:

Well, the answer is yes, to some extent. They do indicate that if a writ is received from a restriction state and it involves an out-of-state account and the financial institution determines that it only involves out-of-state accounts, then the financial institution should consider notifying the issuing state or other issuing entity that the deposit account is located outside of the issuing state so that the court can then make a determination about that. They also indicate that a financial institution should not freeze or place a hold on accounts or charge consumers fees for the garnishment until a writ is properly issued or domesticated in the state where the account is located and retained.

Jessica Simon:

Now, the part about charging consumers for the garnishment, that was an issue that was raised in the consent order. The bureau appeared to frown upon that about charging consumers fees for a financial institution responding to a potentially

invalidly issued writ. So that is something that needs to be considered. But I guess the short answer to your question is that yes, there is some guidance. There is certain forms of notification that they touch upon and I guess some general suggestions about not freezing or placing a hold on accounts, though one may want to consult applicable state law and statutes to determine whether any safe harbors may or may not exist, but they didn't provide a lot of guidance. So a lot of times, I think part of this is, again, getting back to your answer and tailoring a review based on a particular state's requirements and a writ that is issued.

Alan Kaplinsky:

Yeah. I'm not sure we mentioned this, but I found it interesting that the bureau required restitution of the garnishment fees that they either had to put the money back in the customer's account. Or if the customer's account had been closed, I guess, write a check to the customer. But what they didn't do is require the bank to make good on the entire amount that the bank sent out to the judgment creditor. And I was wondering why they did that?

Michael Gordon:

Yeah, that's exactly right. I read the order the same way. It's unclear whether the bureau... Because the bureau never flatly says that funds were garnished that shouldn't have been. In other words, they didn't link particular funds, as you said, that shouldn't have been garnished and therefore should be returned to customers because it shouldn't have been garnished in the first place. They did seize on the fees, which amounted to several hundred thousand dollars over the course of that relevant period. But they didn't order any relief in the form of refunding improperly garnished funds.

Alan Kaplinsky:

Yeah. Well, they did of course impose a \$10 million civil money penalty. I mean, I would say in the case if another bank is trying to figure out what to do and if they decide, boy, in order to conform with this consent order, they're going to have to change a lot of systems. It's going to take a lot of time, a lot of effort. Let's forget about it. The worst case scenario is we only have to give back the fees. And our fees aren't going to amount too much anyway. But the rub is, you never know what kind of a civil money penalty you could end up with.

Michael Gordon:

And I would say that the way the bureau might view this is, banks are on notice that this is a priority for the bureau now. So now if they come and examine you and find a garnishment procedure they think is lacking, they may have even less tolerance for those kinds of mistakes.

Alan Kaplinsky:

Yeah, that's true. They might want restitution of the entire amount that was sent out. So we're getting toward the end of our program today, but there's one more question I have. And I want to ask you, Mike, what are the takeaways with regard to the agreements? Can an account agreement waive exemptions or these garnishment procedures?

Michael Gordon:

It's difficult to give a clear answer on this. This is something that each institution should consult their own council about, frankly. But what is clear from the bureau's perspective is that there are certain exemptions, protections related to the garnishment process that it believes cannot be waived under any circumstances. So a blanket waiver is likely to be frowned upon by the bureau.

Alan Kaplinsky:

Let me say this though. This is an issue of state law, right? I mean, if a state does allow a consumer to enter into an agreement to waive certain garnishment protections under state law, why should the bureau countermand that?

Michael Gordon:

There are a couple reasons. There's a policy reason and then there are legal reasons. The policy reason, of course, from the bureau's perspective is they've always disfavored waiver provisions in contracts that they feel are not being fully negotiated. I think the press release referred to the contract as sort of a take it or leave that contract. I mean, who really negotiates their account opening agreement, right? And so in that context, the bureau is protective of consumers and suspicious of provisions that purport to waive consumer rights that they might be entitled to when they feel like the consumer really has no option there. It's not really a consent. So that's the policy backdrop, I think, that I would say that's how the bureau looks at it. Then there are legal questions surrounding the waivability of state law protections. And again, I think that is actually a complicated question that I don't want to try to parse right now, but there are questions about whether the federal and state exemptions could be contracted around.

Alan Kaplinsky:

Well, at least we know what the Bureau's belief is. And then that may be the only thing that really matters here unless you're willing to litigate the issue with the bureau. And not too many banks are going to be willing to do that.

Michael Gordon:

I would add one other thing, which permeates this entire issue coming out of the consent order. And that is, in the order itself, the bureau is often imprecise about what it thinks the law is and doesn't always explain the basis for its legal conclusion under these various state laws, for example. Which makes it a challenge to view the order as something that everyone could follow even if they wanted to follow because it doesn't really answer all the questions on its face. So I didn't get into some of these complications, but it's unclear, for example, from the bureau's order whether it believes a consumer's already always entitled to the law of the state in which the consumer resides. Whether or not the account resides in the same state, their language is imprecise at various points and they may view the consumer's residents as an overriding factor in determining which law should apply to the garnishment process. So that's one of what I would say are several examples in the order of imprecision that make it a kind of a challenging signal to follow from the bureau.

Jessica Simon:

Just to follow up quickly on what Mike said. So in regard to exemptions, we didn't touch upon this directly but there is this question about which state law applies in the restriction states when you're really dealing with two different forums and issuing state and a sister state, and which state law would you apply to the exemptions and that further complicates the subject a bit more.

Alan Kaplinsky:

Right. Right. Well, I assume this is a complicated area. I mean, it seems simple at first, but then when you really dig into it, there are a lot of nuances. I assume Jessica and Mike that any of our listeners that are with banks have any questions about this, they can certainly contact either one of you because I know you've been involved in helping a lot of banks navigate through this complicated issue.

Alan Kaplinsky:

So I want to thank you both for being on the program today. I want to also thank all of our listeners for downloading the program today and just remind you, we release a new show every Thursday, generally in the morning, except during two holiday weeks, over Thanksgiving and over Christmas. Our shows are available on any platform where you get your podcast. That is Spotify, Google Play. Or you can access the podcast on our website, www.ballardspahr.com. And with that, I wish everybody a good rest of their day. Thank you very much.