

U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Social Security

Statement for the Record

**Protecting Social Security Beneficiaries from Predatory Lending and Other Harmful
Financial Institution Practices**

The Honorable Patrick P. O'Carroll, Jr.

Inspector General, Social Security Administration

June 24, 2008

Good morning, Chairman McNulty, Congressman Johnson, and members of the Subcommittee, and thank you for your invitation to be here this morning to talk with you about an issue that causes my office as much concern as it causes the Subcommittee.

The Office of the Inspector General (OIG) for the Social Security Administration (SSA) is charged by statute with preventing and detecting fraud, waste, and abuse in SSA's programs and operations. While the majority of our work focuses on fraud, through our conduct of criminal investigations, and waste, through our audit work, the issue we are confronting today is one of abuse. Individuals receiving Supplemental Security Income are often among the most vulnerable members of our society. The elderly and the infirm often rely on Social Security payments for their very existence, living month to month on little or nothing but the assistance they receive each month from SSA. For a person or an organization to seek to extract what, for these individuals, are precious dollars, is certainly a crime, even though no criminal statute prohibits it.

Mr. Chairman, in a letter dated February 26, 2008, you asked my office to look into payday loan companies that may be taking advantage of some of SSA's most vulnerable beneficiaries to identify the nature and scope of the problem and suggest solutions to stop this abuse. We recently completed the requested report, and I'd like to share our findings with the Subcommittee.

Background

The ability of both banks and non-bank financial service providers (FSPs), such as payday loan and check-cashing companies, to access and assess fees against individuals' Social Security benefits exists purely as an as-yet unaddressed side effect of the advent of direct deposit. The Debt Collection Improvement Act of 1996 mandated that most Federal payments be made by electronic funds transfer (EFT), or direct deposit. Title II beneficiaries and Title XVI recipients for whom payment by EFT would impose a hardship may request to be exempted from the EFT requirement. Recipients determine what constitutes a hardship, and SSA does not verify or document these self-determinations.

While EFT reduces the Government's workload, eliminates fraud associated with stolen checks and, in most cases, is safe and convenient for beneficiaries, it also creates a process by which

neither SSA nor the beneficiary have full control over the funds throughout the entire payment process. Once sent by EFT, the receiving bank is able to assess such fees and deductions as it wishes. In cases where a non-bank FSP is involved, there are then two entities which are able to control, and assess fees against, these funds before the money is made available to the person for whom it was intended.

Since 1935, it has been illegal for Social Security payments to be garnished, attached, or subject to other legal process. The few exceptions to this prohibition currently include levy by the Internal Revenue Service and garnishment for child support. Of course, times change, and technology changes with them. It is critical that we examine whether current law is sufficient to protect the aged and the disabled from predatory practices in the EFT era.

How FSPs Function with Regard to Social Security Benefits

With beneficiary approval, non-bank FSPs can themselves establish accounts at traditional financial institutions and use those accounts to receive SSA payments intended for the beneficiary. Unlike traditional bank accounts, the beneficiary does not have direct access to deposited funds. Instead, the financial institution makes the funds, less a transaction fee, available to the non-bank FSP for disbursement to the beneficiary. The non bank FSP then deducts additional fees for their services and makes the remaining balance available to the SSA beneficiary.

This practice appears to be inconsistent with Section 207 of the Social Security Act, which protects a beneficiary's right to receive benefit payments directly and use them as he/she sees fit by prohibiting the assignment of benefits. Assignment is the transfer of the right to, or payment of, benefits to a party other than the beneficiary or his/her representative payee. It also appears to be inconsistent with SSA policies prohibiting payment of benefits to anyone other than the beneficiary or representative payee. Specifically, SSA's policy states that "Any arrangement in which the claimant shares control of the funds from his or her benefit with a person or entity that has an interest in charging or collecting money from the claimant is an assignment-like situation that violates SSA's policy."

To further exacerbate an already troubling issue, we have seen cases in which a beneficiary using an FSP-established bank account for direct deposit notified SSA that he wanted to terminate the EFT agreement, and the following month, the FSP and the bank re-established the EFT against the beneficiary's wishes.

On April 21, 2008, SSA published in the Federal Register a proposed policy change to prevent deposits to "third party" accounts such as those I've described. I applaud this step, and encourage SSA to take all possible action to protect its beneficiaries.

Results of Our Audit

Our auditors performed a limited review of SSI payments electronically deposited into accounts at five banks known to have financial relationships with non bank FSPs. While these are by no means the only banks used by FSPs to facilitate third-party accounts, we identified these five banks either because (1) their bank routing number appeared on payment records of SSI

recipients whose address reflected the business name of a non-bank FSP; or (2) SSA identified the bank to us as the result of complaints received from SSI recipients.

Our review determined that, as of March 2008, SSA deposited the SSI payments of at least 63,065 individuals into accounts established and controlled by non bank FSPs at these five banks. Monthly SSA payments deposited into these accounts total more than \$34 million.

In a few hundred cases, SSA payment records reflected the non-bank FSP's name and address-indicating that SSA was aware that payments were going to the non-bank FSPs. However, in most cases, SSA payment records did not directly indicate non-bank FSP involvement in the payment transaction. In these instances, it appeared that SSI recipients or their representative payees entered into agreements with non-bank FSPs who, in turn, opened bank accounts on the recipients' behalf at traditional financial institutions with Department of Treasury-assigned routing numbers. Either the recipients submitted electronic deposit requests to SSA, providing the bank routing and account numbers used by the non-bank FSP, or the financial institution sent direct deposit auto enrollment information directly to Treasury. In either case, once the direct deposit requests were processed, SSA began sending these individuals' payments to accounts effectively controlled by the non-bank FSPs. Once received, the financial institutions made the funds available to the non-bank FSPs for disbursement to the recipients. Before disbursement, the non-bank FSPs subtracted their fees from the recipients' funds.

Consumers who use non-bank FSPs typically pay higher costs in the form of transaction fees for financial services than individuals with traditional banking relationships. Treasury research indicates that Social Security recipients pay an average of between \$9 and \$16 in fees just to cash their Government check at a non-bank FSP. This suggests that the five non-bank FSPs and their financial institution partners charge the 63,065 recipients between \$567,585 and \$1,009,040 in monthly check cashing fees.

We also studied the demographics of the 63,065 beneficiaries in our sample. Seventy-six percent of these recipients were minorities. Ninety-six percent of the recipients were disabled-slightly higher than the 82 percent of disabled individuals reflected in the overall SSI population. Fifty-five percent of the individuals in our sample received SSI payments based on mental disabilities including mental retardation, mood disorders, and psychotic disorders. The age range of individuals in the sample was from four months old to 105 years old, and the median age was 42 years.

It is also notable that 42 percent of the population had representative payees-persons appointed by SSA to handle the payments of recipients unable to administer their own funds. While this percentage is closely reflective of the SSI recipient population at large, we believe the use of FSPs by representative payees casts doubt on whether the payments are in fact being used for the benefit of the recipient. We note, however, that SSA pointed out that many of these representative payees are equally poor family members who also may not have access to a traditional bank account.

SSA's Prevention of the Transfer of Payments to FSPs

As I stated earlier, SSA has published proposed policy changes to address these issues. However, at the time of our review, we found that in most cases, SSA was not aware that it was depositing SSI payments into accounts controlled by non-bank FSPs. Further, we identified no action taken by SSA to prevent the transfer of payments to payday lenders or any other non-bank FSP. On the contrary, though some SSA policies appear to prohibit these types of arrangements, other policies outline steps to follow to send payments directly to non-bank FSPs.

For example, one SSA policy states that, with the exception of Internal Revenue Service levy, child support (and/or alimony) garnishment, or state reimbursement, “. . . do not pay benefits to anyone other than the beneficiary (or his/her representative payee).” Another policy states that the Agency should “. . . avoid payment situations that give physical control over a benefit payment to someone other than the beneficiary; e.g., sending a benefit payment, either by check or electronically, to a loan company where the beneficiary has a loan. . . .” Yet another policy states that “Direct deposit payments cannot go directly to any of the following types of institutions:

- credit card companies,
- finance companies,
- insurance companies, or
- other non-traditional financial service companies.”

Yet, in an apparent contradiction, another policy states that “Since direct deposit is now the presumed method of payment and will be required for all Government payments in the final phase of the new direct deposit requirements, many non-bank financial service providers, such as loan companies and check cashing facilities [emphasis added], now offer direct deposit for their customers. The direct deposit may be arranged in one of the following ways. . . .” The policy goes on to describe how to set up these direct deposits by stating, “This type of arrangement is acceptable and does not constitute assignment of benefits if all the following requirements are met:

- The benefits must be deposited in an account owned by the beneficiary at a Financial Institution . . .
- Enrollment must be voluntary on the part of the beneficiary.
- The beneficiary must be able to terminate the direct deposit arrangement upon request.
- Funds paid to a representative payee through a non-bank Financial Service Provider must be used for the beneficiary’s current needs.”

Despite this, in our review we identified two field offices that openly encouraged homeless SSI recipients to receive payments through local FSPs. Field office management visited local non-bank FSPs and compiled a short list of preferred vendors that wanted SSA customers.

Conclusion

Certainly SSA recognizes that this issue must be addressed, and the OIG acknowledges that electronic banking has increased the complexity of benefit delivery. SSA and the OIG agree that

we must find a way to balance the need to pay beneficiaries in a safe, electronic, and timely manner with the need to ensure that beneficiaries have absolute control over their funds.

We look forward to continuing to work with SSA, and with this Subcommittee, to find solutions to these challenges and to protect and serve these most vulnerable beneficiaries and recipients. Again, I thank you for the invitation to speak to you today, for your interest, and for your continued support of our efforts. I'd be happy to answer any questions.