Operation Choke Point

What It Is and Why It Matters

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Executive Summary

Can the government shut down legal but politically disfavored businesses? If an ongoing federal regulatory campaign continues, that may be precisely what happens. In recent months, a federal government regulatory initiative called Operation Choke Point has gained increased public and media attention. Operation Choke Point is ostensibly a joint effort by various regulatory entities—the Department of Justice (DOJ), Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation (FDIC) most prominent among them—to reduce the chances of Americans falling victim to fraud in a variety of "high-risk" industries, predominantly payday lending. It uses existing regulatory powers to provide heightened supervision of banks that do business with the third-party payment processors that provide payment services to these industries.

However, this seemingly laudable aim conceals a worrying reality. There is nothing illegal about most of these industries (at least not yet). But because they have been designated high risk, banks are cutting off dealings with many processors and companies preemptively. As a result, many companies and individuals that have done nothing wrong have been frozen out of banking services. Without the links to banks, their financial lifeblood is choked off indeed.

Operation Choke Point echoes—and may in fact be modeled on—the federal government's takedown of the otherwise legal American online poker industry in 2011. In that instance, regulators targeted payment processors that dealt with gambling businesses. As a result, banks became wary of doing business with those targeted payment processors. Finding their lifeblood cut off, some companies had no choice but to turn to less scrupulous processors or disguise transactions with them, leading to criminal liability—which in turn allows DOJ to close down the industry. Operation Choke Point appears to be heading down this road.

The development of Operation Choke Point appears to have begun with a 2011 FDIC circular that noted "an increase in the number of deposit relationships between financial institutions and third-party payment processors and a corresponding increase in the risks associated with these relationships," including "greater strategic, credit, compliance, transaction, legal, and reputation risk."

The circular also explained how certain industries appeared to be at greater risk of fraud than others, including: ammunition sales, cable box de-scramblers, coin dealers, credit card schemes, credit repair services, dating services, drug paraphernalia, escort services, firearms, fireworks, home-based charities, lifetime guarantees, lifetime memberships, lottery sales, money transfer networks, online gambling, payday loans, pornography, tobacco, travel clubs, and many others.

The list of high-risk payment types was broadly drawn, with no indication as to the criteria inclusion on the list. Since then, a series of actions by the agencies participating in Operation Choke Point, led by the Department of Justice, have sought to crack down on these politically disfavored industries by choking off their access to the financial system.

The motivation behind the FDIC's involvement in Choke Point has been the agency's concern about "reputational risk." It is not a regulator's—much less a criminal investigator's—role to define reputational risk. Such a judgment is best left up to individual banks, which have a much better idea of the risks involved in their client relationships.

While Operation Choke Point seems to have its origins in the worthy goal of tackling payment processor fraud, the Department of Justice's application of the FDIC guidance has done nothing to protect consumers and has gone a long way to undermine the rule of law.

Operation Choke Point has had a demonstrable chilling effect on commerce. Banks are already highly regulated. The burden of regulation is such that small and mid-size banks around the country are merging to deal with the compliance costs. Most such banks cannot afford the extra supervision that comes with a Choke Point subpoena. Thus, they often face no other choice but to drop payment processors and designated "high-risk" clients altogether.

Customers, meanwhile, are left with no recourse. Payday lenders' customers are often "unbanked" and have no viable credit rating. They will therefore be tempted to seek out dubious or even illegal loan sources. Similarly, gun and ammunition purchases may increasingly be done off the books. The porn industry has only recently stepped out of the shadows, and it would be extremely negative for performers and customers to push it back into the shadows.

Operation Choke Point forces banks to do the investigators' work for them by scrutinizing their customers' business methods for potential criminal violations. While due diligence is to be expected from banks, criminal investigative duties are not. Shifting the costs onto supervised bodies is not an acceptable principle of governance. Businesses need to be allowed to make their own business decisions without the threat of being required by their regulators to do their job for them.

The FDIC's list of high-risk industries seems guided more by moral censure than by any real prospect of criminality. If "reputational risk" is a significant factor in designating an industry "high risk," then it is not too difficult to imagine a future FDIC in more "conservative" times designating a whole different list of industries. For instance, otherwise legal marijuana sellers might make the list. So might abortion providers.

Policy makers should weigh Operation Choke Point's few successes in stopping genuine fraudsters against its significant harm to customers of legal businesses who will become unable to access services they had hitherto enjoyed. In some cases, they may be pushed to seek the now-unobtainable service from illegal providers, with subsequent risks to their health, liberty, or both.

Congress should demand an immediate investigation by the Department of Justice's Office of the Inspector General into the appropriateness of actions by officials at all levels relating to Operation Choke Point. Congress should also refuse to allow any funds to be used for Operation Choke Point until it has done everything in its power to curb its potential for abuse. Otherwise, lawmakers should choke off Choke Point.

Introduction

Can the government shut down legal but politically disfavored businesses? If an ongoing federal regulatory campaign continues, we may be facing precisely that scenario. In recent months, a federal government regulatory initiative called Operation Choke Point has gained increased public and media attention. Operation Choke Point is ostensibly a joint effort by various regulatory entities—the Department of Justice (DOJ), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) most prominent among them—to reduce the chances of Americans falling victim to fraud in a variety of "high-risk" industries, predominantly payday lending. It uses existing regulatory powers to provide heightened supervision of banks that do business with the third-party payment processors (TPPP) that provide payment services to these industries.

However, this seemingly laudable aim conceals a worrying reality. There is nothing illegal about most of these industries (at least not yet). Yet because they have been designated high-risk, banks are cutting off dealings with many processors and companies preemptively, before Choke Point's heightened supervision comes into play. As a result, many companies and individuals that have done nothing wrong have been frozen out of banking services. Without the links to banks, their financial lifeblood is choked off indeed.

Policy makers should weigh Operation Choke Point's few successes in stopping genuine fraudsters against this significant chilling effect, of which the primary victims are the customers of legal businesses who will become unable to access services they had hitherto enjoyed. In some cases, this chilling effect will push customers of the now-unobtainable service towards illegal providers, with subsequent risks to their health, liberty, or both.

Many companies and individuals that have done nothing wrong have been frozen out of banking services.

Poker

Operation Choke Point appears to be largely modeled on the federal government's takedown of the otherwise legal American online poker industry in 2011. Here is how it happened.

The federal government justified its crackdown on online poker under the 1961 Wire Act, which bans interstate gambling on sporting events. Passed at the urging of Attorney General Robert F. Kennedy, the Act was intended to target the Mob by choking off some of its otherwise legal income.[1] Kennedy maintained that the purpose of the law was to punish mobsters, not individual gamblers. Yet, the Wire Act proved ineffective for its stated purpose, and the Mob was not truly foiled until the passage of the Racketeer Influenced and Corrupt Organizations Act in 1970. The Department of Justice, however, began to enforce the Act on the basis that it covered *all* forms of gambling over telecommunications lines, punishing

In 2002, a federal court found that the plain language of the Wire Act does not forbid Internet gambling on games of chance, but only on sporting events. Despite this ruling, the Department of Justice did not noticeably change its policies.

individual gamblers despite the bill's clear intent.[2]

In 2002, a federal court found that the plain language of the Wire Act does not forbid Internet gambling on games of chance, but only on sporting events.[3] Despite this ruling, the Department of Justice did not noticeably change its policies. In 2003, the Department announced that, despite the ruling, it still interpreted the law as applying to all online gambling and that advertisements for gambling services could be construed as aiding and abetting.[4] This resulted in Google and Yahoo! dropping such advertisements.[5]

In 2006, in its final hours before adjourning before that year's November midterm elections, Congress passed the Unlawful Internet Gambling Enforcement Act (UIGEA) as part of a port security bill, the Security and Accountability for Every Port Act. As part of its findings, UIGEA stated that, "Internet gambling is a growing cause of debt collection problems for insured depository institutions and the consumer credit industry," clearly establishing risk to financial institutions as a rationale for the law. It did not outright ban online gambling, but made it illegal for payment systems or financial transaction providers to enable online wagering, where "such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made."[6]

With the law being so vague, the online poker industry reacted in various ways. Some companies stopped service in the U.S. altogether. Others continued to serve the American market, but developed complex relations with payment processors. In 2009, the U.S. Attorney's Office for the Southern District of New York ordered Citibank, Wells Fargo, and two Arizona banks to freeze payments to 27,000 poker players processed by two companies, Allied Systems and Account Services, under the legal justification that the payments "constitute property involved in money laundering transactions and illegal gambling offenses." The legal authority cited was the Wire Act, despite the 2002 court ruling. The poker companies affected compensated the poker players out of their own funds. Despite the questionable legality of the move, the case was not challenged in court, with most parties involved preferring to settle rather than face lengthy and expensive court action.

In 2010, UIGEA-derived regulations required participants in certain payment systems—Automated Clearing House (ACH) systems, card systems, check collection, money transmitting businesses, and wire transfer systems—to establish policies and procedures "to identify and block or otherwise prevent or prohibit any transaction" involving unlawful internet gaming. Card systems reacted by establishing a new merchant category code for gaming purchases. Many banks chose to indiscriminately block all card

transactions containing this code. As a senior executive at one payment processor noted, "It is clear that the banking industry still has concerns regarding the appropriate interpretation of these regulations by their governing bodies."[7]

Things came to a head in 2011 when, once again, the New York Southern District took drastic action. It indicted three poker companies over bank fraud, illegal gambling offenses, and money laundering under UIGEA. The Attorney's Office reasoned:

> Because U.S. banks and credit card issuers were largely unwilling to process their payments, the Poker Companies allegedly used fraudulent methods to circumvent federal law and trick these institutions into processing payments on their behalf. For example, defendants … arranged for the money received from U.S. gamblers to be disguised as payments to hundreds of non-existent online merchants purporting to sell merchandise such as jewelry and golf balls. Of the billions of dollars in payment transactions that the Poker Companies tricked U.S. banks into processing, approximately one-third or more of the funds went directly to the Poker Companies as revenue through the "rake" charged to players on almost every poker hand played online.[8]

The criminal penalties were light—the longest sentence received for the offenses was three years in prison—but the effect on the online gaming industry was crippling. Of the three companies indicted, Cereus (based in Antigua, which had successfully complained to the World Trade Organization in 2007 over U.S. efforts to ban its gaming industry) went bankrupt. Full Tilt was sold to the remaining company, PokerStars, as part of an agreement with the Department of Justice that led to the dismissal of the complaint's civil charges. While PokerStars and Full Tilt are back online in the U.S., they now offer completely free products. Thousands of professional poker players have lost their livelihoods as a result.

It is not clear that UIGEA should apply to online poker at all. UIGEA is aimed at preventing the funding of illegal betting on games of chance. There are several court decisions that find that poker is actually a game of skill rather than of chance, as well as statistical studies to back them up.[9]

What happened to the online paid poker industry should serve as a warning to other industries that incur moralistic censure. The pattern seemed to go this way: Debt collection problems led to the creation of a new law that targeted payment processors. Regulators unilaterally "interpreted" a narrowly directed law to broader uses for which it was not intended, even in defiance of court rulings. Banks became wary of doing business with payment processors that deal with said industry. Finding their lifeblood cut off, some companies

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turn to less scrupulous processors or disguise transactions with them, leading to criminal liability—which in turn allows the Department of Justice to close down the industry.

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Historical Timeline

The development of Operation Choke Point appears to have begun in 2011. A comprehensive timeline follows.

- In the summer of 2011, the FDIC issued the circular, Supervisory Insights (Volume 8, Issue 1), which contained a summary article on third-party payment processors entitled, "Managing Risks in Third-Party Payment Processor Relationships."[10] It began:

  > During the past few years, the Federal Deposit Insurance Corporation (FDIC) has observed an increase in the number of deposit relationships between financial institutions and third-party payment processors and a corresponding increase in the risks associated with these relationships. Deposit relationships with payment processors can expose financial institutions to risks not present in typical commercial customer relationships, including greater strategic, credit, compliance, transaction, legal, and reputation risk[11]

The circular focused on two aspects of concern: Remotely Created Checks (RCCs) and types of high-risk payments. It defined RCC as follows:

> Similar to the initiation of an ACH debit transfer, an account holder authorizes the creation of an RCC by providing his financial institution's routing number and his account number. Examples of RCCs are those created by a credit card or utility company to make a payment on an account, or those initiated by telemarketers or online merchants to purchase goods or services.[12]

The circular noted that there was a higher risk of fraud with RCCs because the details could be copied from a genuine check or use data obtained under false pretenses. It also pointed out that regulatory changes "shifted the liability for losses attributed to unauthorized RCCs to the financial institution where the check is first deposited as this institution is in the best position to know its customer (the creator of the RCC) and determine the legitimacy of the deposits."[13]

The circular also described in detail how certain industries appeared to be at greater risk of fraud than others:

> Although many clients of payment processors are reputable merchants, an increasing number are not and should be considered "high risk." These disreputable merchants use payment processors to charge consumers for questionable or fraudulent goods and services. Often a disreputable merchant will

engage in high pressure and deceptive sales tactics, such as aggressive telemarketing or enticing and misleading pop-up advertisements on Web sites. For example, consumers should be cautious when Web sites offer “free” information and ask consumers to provide payment information to cover a small shipping and handling fee. In some instances and without proper disclosure, consumers who agreed to pay these fees, often found their bank accounts debited for more than the fee and enrolled in costly plans without their full understanding and consent. Still other disreputable merchants will use processors to initiate payments for the sale of products and services, including, but not limited to, unlawful Internet gambling and the illegal sale of tobacco products on the Internet.[14]

The list of high-risk payment types was quite broadly drawn, with no indication as to what criteria had to be met to be included in it:

- Ammunition Sales
- Cable Box De-scramblers
- Coin Dealers
- Credit Card Schemes
- Credit Repair Services
- Dating Services
- Debt Consolidation Scams
- Drug Paraphernalia
- Escort Services
- Firearms Sales
- Fireworks Sales
- Get Rich Products
- Government Grants
- Home-Based Charities
- Life-Time Guarantees
- Life-Time Memberships
- Lottery Sales
- Mailing Lists/Personal Info
- Money Transfer Networks
- On-line Gambling
- PayDay Loans
- Pharmaceutical Sales
- Ponzi Schemes
- Pornography
- Pyramid-Type Sales
- Racist Materials
- Surveillance Equipment
- Telemarketing
- Tobacco Sales
- Travel Clubs[15]

The circular also outlined warning signs for potentially fraudulent activity. They included:

- Internet complaints (e.g. Better Business Bureau) mentioning the merchant
- Internet complaints mentioning the bank
- A large number of check returns or chargebacks
- A significant level of activity resulting in high fee income
- “Nested” activity where the processor has relationships with more than one financial institution
- Payment processors seeking relationships with troubled financial institutions

The list of high-risk payment types was quite broadly drawn, with no indication as to what criteria had to be met to be included in it.

No justification was given for including legal payment processing and payday lending businesses in with a group of patently illegal activities.

The FDIC's guidance called for a long list of due diligence activities by banks dealing with processors with clients in high-risk industries, included detailed—in some cases intrusive—examinations of the processors' business methods, and required banks to request detailed information on the processors' clients.

The FDIC noted that third-party processors are not covered by regulations under the Bank Secrecy Act, which require banks to report suspected illegal transaction. It also pointed out that the Federal Financial Institutions Examination Council "urges financial institutions to effectively assess and manage risk with respect to third-party payment processors" by means of ongoing monitoring, including chargeback history.[17]

Finally, FDIC called for "appropriate supervisory responses," including various penalties under the Federal Deposit Insurance Act and the Federal Trade Commission Act, if it were to determine that the bank is "aiding and abetting" the merchants. Penalties could include a requirement to cease business with the processor, monetary penalties, or both.[18]

- In February 2012, a Consumer Protection Working Group of the Financial Fraud Enforcement Task Force—established by the President under the chairmanship of Attorney General Eric Holder in 2009—was established by the Department of Justice.[19] The group's initial co-chairs were U.S. Attorney for the Central District of California Andre Birotte; Assistant Attorney General for DOJ's Civil Division Tony West; Richard Cordray, then-nominee for Director, Consumer Financial Protection Bureau; Director of the Federal Trade Commission's Bureau of Consumer Protection David Vladeck; and Assistant Attorney General for DOJ's Criminal Division Lanny Breuer.

The group's stated mission was to tackle consumer financial fraud that could "financially cripple some of our most vulnerable consumers, wreak havoc on our economy, and, in some instances, threaten the safety and soundness of financial institutions." Its areas of interest included, "[i]dentity theft, third-party payment processors and other payment fraud, student-consumer fraud, cramming, business opportunity schemes, data privacy, payday lending, counterfeiting, and schemes targeting servicemembers [sic] and their families."[20] No justification was given for including legal payment processing and payday lending businesses in with a group of patently illegal activities. The press release announcing the group's formation was even more explicit, stating, "The Consumer Protection Working Group will address several areas of concern, including payday lending and other high-pressure telemarketing or Internet scams," thereby immediately labeling payday lending a "scam."

- At a May 2012 meeting of the working group, participants talked explicitly about "targeting of third-party payment

processors" that "process victim payments through ACH [Automated Clearing House], third-party checks, credit cards, etc., despite notice of fraud."[21] A diagram attached to the meeting notice described the process by which Payment Processing Center LLC (PPC) had defrauded consumers.[22] PPC had been heavily involved in processing Internet gambling payments to the tune of $44 million. It had also engaged in consumer fraud, tricking mostly elderly consumers out of approximately $60 million though a scam that involved telemarketers persuading elderly victims to reveal their bank account information to be used to present a third-party check request to the victim's bank.[23] The diagram noted a high rate of "returned deposit items," also called chargebacks, where the victim challenged the payment, of about 50 percent. Another attachment from a bank noted a business account that had produced 4,579 chargebacks in two months, all third-party checks.[24] These examples are presumably meant to be representative of all payment processing relationships with banks. No caveats were included as to legitimate uses.

- In October 2012, a note to various members of the working group contained the first reference to charges being brought against a bank, the First Bank of Delaware, under the Financial Institutions Reform, Recovery, and Enforcement Act, for its relationship with a payment processor.[25] Assistant U.S. Attorney Joel Sweet, who brought the charges, sought a penalty of $15 million, "the largest ever to be paid under FIRREA [the Financial Institutions, Return, Recovery, and Enforcement Act of 1989]." Sweet had expressed interest to a working group member "about possibly coordinating an effort to investigate more banks for potential FIRREA violations resulting from their relationships with processors."[26]
- In November 2012, the DOJ's Civil Division received a formal proposal from Sweet that recommended for the Consumer Protection Branch to "implement a strategy to attack Internet, telemarketing, mail, and other mass market fraud against consumers, by choking off fraudsters' access to the banking system" to be called Operation Choke Point.[27] In his proposal, Sweet noted: "Banks are sensitive to the risk of civil/criminal liability and regulatory action."

Under FIRREA, regulators may issue investigative subpoenas to banks. Sweet noted that, "We can expect the bank to scrutinize immediately its relationships with third-party payment processors and fraudulent merchants and, if appropriate, to take necessary action." Sweet continued, "This approach can yield almost immediate prospective protection of the public at an extremely low cost." Sweet admits that part of the purpose of Operation Choke Point is to shift the cost of investigating suspected fraudulent processors and merchants from the

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regulators to banks. In effect, Sweet's proposal amounted to the forcible deputizing of banks by the DOJ and other regulations to do their job for them.

On November 5, 2012, Sweet's proposal was endorsed by Maame Frimpong, Deputy Assistant Attorney General for the Consumer Protection Branch in the Civil Division of the DOJ.[28]

- In February 2013, requests for the first subpoenas under Operation Choke Point went out.[29]
- In a March 2013 speech at the Exchequer Club of Washington, D.C, Michael Bresnick, Executive Director of the Financial Fraud Enforcement Task Force, made the first public mention of Operation Choke Point, though he did not reveal its official title. In his speech, Bresnick said that, "[T]he reason that we are focused on financial institutions and payment processors is because they are the so-called bottlenecks, or choke points, in the fraud committed by so many merchants that victimize consumers." He argued that, "[T]oo many banks allow payment processors to continue to maintain accounts…despite the presence of glaring red flags indicative of fraud, such as high return rates." He called return rates of 30 percent or higher "ambulance sirens, screaming out for attention.[30]

Bresnick also noted that the feds were giving special attention to banks' relationships with "the payday lending industry," rather than specific payday lenders, because "some payday lending businesses operating on the Internet have been making loans to consumers in violation of the state laws where the borrowers reside."

- In April 2013, the DOJ's "Operation Choke Point: Eight-Week Status Report" reported a disagreement by DOJ with the CFPB [Consumer Financial Protection Bureau] over legal strategies and that "recent communications concerning payday lending have received no response."[31] The report also indicated an emerging concern over stored-value prepaid debit cards, which are not subject to many regulations that affect bank accounts. It also noted that the FDIC had agreed to insure an American Express prepaid card. This was an early indicator of mission creep away from payment processors, to encompass other businesses.
- In May 2013, porn star Chanel Preston reported her bank account was closed because of her occupation.[33] The closure was later linked to Operation Choke Point, as other porn performers corroborated with their own stories about accounts being closed over their chosen career.[33] Online pornography has a generally high payment return rate, which is presumably why it was included in the FDIC list mentioned above,

though in the case of porn it is often for obvious reasons that have nothing to do with criminality, mainly guilt or shame, or the occasional angry spouse.

- In July 2013, the Four Month Status Report for Operation Choke Point gave the first official indication that Choke Point had become a fishing expedition rather than a targeted anti-fraud effort. The report noted "substantial anecdotal evidence that our efforts are causing banks to scrutinize potential third-party processor relationships more closely."[34] It also revealed that the DOJ had "served subpoenas on banks and payment processors that are facilitating the Internet payday loan industry, in an effort to learn more about their practices" based on a "belief" that the industry may be violating state lending laws. The report also indicated that officials of several states, including New York, had requested to work with Operation Choke Point.

- Also in July 2013, an official DOJ Consumer Protection Branch training presentation included a section on Operation Choke Point that noted that, "[C]utting off the scammers' access to the payment systems is relatively efficient (compared to investigations and litigation against scammers)." The presentation also noted that over 50 subpoenas had been issued and that "banks are terminating TPPP" relationships.

- In August 2013, New York Financial Services Superintendent Benjamin Lawsky instructed 117 banks, including the nation's four largest, to develop safeguards to, in his words, "choke off" unlicensed online lenders' access to the payments system. Lawsky also filed suit against online lenders that he said were violating New York's interest-rate cap. "We're really trying to take a shock-and-awe strategy," Lawsky said. "We want to make payday lending into New York, over the Internet, as unappetizing as possible."[35]

- Also in August 2013, in a response to an inquiry by a *Wall Street Journal* reporter, DOJ official Michael Blume said that "getting the message out that DOJ is interested in on-line payday lenders and the potential abuses is important."[36] The *Journal* story, published on August 8, focused on online payday lending and quoted an unnamed DOJ official who talked about "choking them [fraudulent merchants] off from the very air they need to survive." It also quoted Peter Barden of the Online Lenders Alliance, who said the tactic "should also send a troubling message to banks that at any point regulators can force them to stop processing legal transactions simply because they don't like a particular merchant or industry."[37] Following the *Journal* story's publication, Republican lawmakers in Congress condemned Operation

Peter Barden of the Online Lenders Alliance said the tactic "should also send a troubling message to banks that at any point regulators can force them to stop processing legal transactions simply because they don't like a particular merchant or industry."

Choke Point, accusing the Justice Department of intimidating banks to cut off payday lenders.

- In an August 15, 2013 memo to Maame Frimpong of the Consumer Protection Branch, Joel Sweet noted that he had explained to a representative of the Native American Financial Services Association that the initiative was "not focusing on tribal" Internet payday lending (IPDL). He suggested to him that "banks are becoming more sensitive about the risk of TPPP relationships and high-risk merchants, and that rather than criticize DOJ's efforts to protect consumers from fraud, NAFSA perhaps should direct its efforts at convincing banks that tribal IPLD [sic] is lawful and not high risk."[38] This was the first indication of a theme later repeated—that the burden of proof of legality is on the industry, rather than on the regulators.
- An August 21, 2013 letter to Maame Frimpong from NAFSA (following a meeting with Frimpong) claimed that she had told the tribal members, "It didn't occur to me that we should consult with tribes in advance because we are going after fraud. *Never have we focused on tribal payday or payday*."[39] [Emphasis added]
- In an August 22, 2013 article in *American Banker*, attorney Peter Weinstock outlined the effect Operation Choke Point was having on the financial industry:

> The FDIC has been descending on banks threatening enforcement action to the extent they can find weakness in compliance management systems. Examinations are lasting weeks during which management teams are burdened with extensive document requests.

Weinstock also noted that the Dodd-Frank Act authorized the CFPB, not the DOJ or FDIC, to regulate payday lending. In relation to TPPPs, Weinstock pointed out that, "[T]hey are so prevalent in the banking system that we do not even consider them as third parties. … There are software companies that process payments…for the vast majority of online businesses that are too small to do this work themselves. In fact, the vast majority of payroll in this country and the tax payments for payroll are performed by third part payment processors."[40]

Weinstock also pointed out that DOJ was using a return rate of 3 percent as a signal for fraud, despite this not distinguishing "among the type of return (unauthorized entries are very different from returns due to insufficient funds), the nature of the transaction or the customer base (poor people tend to bounce more items.)" In an email to his colleagues, Joel Sweet confirmed, "[O]ur subpoenas ask banks to produce documents identifying TPPP and merchants with total return rates of 3 percent or more."[41]

- In the Operation Choke Point Six-Month Status Report, issued on September 9, 2013, the government for the first time acknowledged that the Operation might be deterring banks from dealing with legitimate lenders. In fact, the report celebrated that:

  > Segments of the banking industry that had been doing business with third-party payment processors have chosen to exit or severely curtail that business, thereby making it harder—and in some cases impossible—for untold numbers of merchants who prey on consumers to run their *legitimate* operations. [Emphasis added]

The report said that, "we consider this to be a significant accomplishment." It argued:

> Although we recognize the possibility that banks may have…decided to stop doing business with legitimate lenders, we do not believe that such decisions should alter our investigative plans. Solving that problem—if it exists—should be left to the legitimate lenders themselves who can, through their own dealings with banks, present sufficient information to the banks to convince them that their business model and lending operations are wholly legitimate.[42]

The report also addresses the use of the Financial Institutions Reform, Recovery, and Enforcement Act as the principal tool used to investigate banks and third-party payment processors. While it admits that, "FIRREA's penalty provision was not designed primarily to address consumer fraud," the report outlines various court judgments that have made FIRREA an appropriate tool for penalizing fraud offenses "affecting a federally insured financial institution." It is argued that the banks are at risk because they could be held responsible for bogus charges or "suffer reputational harm," echoing FDIC's 2011 guidance. The report also admits that, "The financial institutions we are investigating have not suffered any actual losses," but notes that "such actual losses are not necessary under FIRREA."[43]

The report noted that FIRREA allows for higher penalties than the statutory $1 million per violation based on the total loss to victims or gain to the fraudsters. It concluded, "[A] multiple of the bank's revenue or profits…will obtain the *deterrent effect* we seek." [Emphasis added] The report also noted that early cases were likely to be settled for low amounts owing to banks' inability to pay, and raised the worry that this might be seen as a benchmark limiting higher penalties. Finally, the report reiterated the strategy of targeting banks over processors and processors over merchants in order to "prevent the initiative from grinding to a halt due to resources used pursuing merchants and processors."

In American Banker*, an unnamed Justice Department official was quoted as saying, "The system is working and as a result, banks are cutting off processors, processors are cutting off scammers, and scammers are starting to get desperate for a way to access consumers' bank accounts."*

- In September 2013, the Online Lenders Alliance launched a public relations campaign pushing back against the stepped up scrutiny from federal and state authorities. An article in *American Banker* summarized the concerns:

  > The upshot is that some storefront and online lenders that are following all relevant laws are suddenly unable to meet loan demand, according to Lisa McGreevy, the president and chief executive of the Online Lenders Alliance, an industry trade group. "The people who are getting cut off from banking and payment-processing services include storefronts and [lenders] who are licensed in every state," McGreevy said in an interview. "It's an across-the-board attack."[44]

- On September 17, 2013, the Federal Financial Institutions Examination Council held a conference that included a panel on "Third-Party Payment Processors: Relationship, Guidance, and Case Examples," featuring Joel Sweet and colleagues from FDIC and the Office of the Comptroller of the Currency. The slides from the presentations were made public and included the first such reference to the existence of Operation Choke Point. The FDIC presentation included much of the list of high-risk businesses from the earlier FDIC guidance mentioned above.[45]

- In a September 25, 2013, *American Banker* article about an "online lending probe," an unnamed Justice Department official was quoted as saying, "The system is working and as a result, banks are cutting off processors, processors are cutting off scammers, and scammers are starting to get desperate for a way to access consumers' bank accounts."[46]

- In an October 1, 2013 internal email to Maame Frimpong, Michael Blume noted that discussion had occurred on whether the DOJ should use "specific language on payday lending." In addition, "[S]ome proposals to banks have included specific bans doing business [sic] with debt relief companies, foreclosure rescue companies, and credit repair companies, and finding alternative, non-specific language presents unique challenges."[47]

- A November 2013 internal DOJ email in which Frimpong outlined talking points about Choke Point, included the claim that "The regulators are also taking action, and reinforcing their longstanding guidance on what are 'high-risk merchants' and what due diligence banks should do on such merchants," indicating a broader intent to the initiative from DOJ than online lending.[48]

- A November 21, 2013 memo from Frimpong to the Attorney General's office outlining Operation Choke Point

contained the following important revelations:

- Operation Choke Point's "primary" support outside the DOJ came from the United States Postal Inspection Service.
- All civil investigations were pursuing the same types of evidence as would be sought in a criminal investigation to hold open the possibility of criminal prosecutions.
- Most of the cases would be "based upon bank officials' or processors' willful blindness to obvious red flags of fraud" (harking back to the Bresnick speech mentioned above) to establish *mens rea*.
- FIRREA subpoenas had been served on "approximately fifty banks and six payment processors."
- Frimpong notes, "Most importantly, we have learned directly from many sources that banks that have received our subpoenas, *and others aware of our efforts*, are scrutinizing their relationships with high-risk third-party payment processors." [Emphasis added]
- Articles about the operation were celebrated as a "deterrence multiplier."
- In a section titled, "Our effects on the payday lending industry," the memo noted: "Banks are terminating large swaths of deceptive payday lending businesses from their account portfolios. Some of these banks have ceased doing business with all Internet payday lenders, but we are unaware of any terminated merchants that operated in a wholly legitimate fashion with terms that are transparent to consumers."
- The memo alleges that a letter to DOJ and FDIC from "several members of the US House of Representatives" was "directed and funded primarily by the owner of a particular payment processor presently under investigation."
- Frimpong's memo recognizes "the possibility that some banks may decide to exit relationships with payday lenders that claim to be operating lawfully. We do not, however, believe that this possibility should alter our investigative activities."
- Once again, it is noteworthy that no cooperation with the CFPB was mentioned.[49]

- The first proposed settlement under Operation Choke Point came in January 2014. A small North Carolina institution, Four Oaks Bank, was asked to pay $1.2 million in civil penalties for "routing more than $2.4 billion in transactions for fraudulent payday lenders—and [taking] more than $850,000 in fees to do so,

according to the civil lawsuit." The bank agreed to the terms in April. Its first quarter income for 2014 was a mere $1.4 million.[50]

- On January 8, 2014, House Oversight and Government Reform Committee Chairman Darrell Issa (R-Calif.)wrote to Attorney General Holder outlining several concerns about Operation Choke Point:
    - **Possible misuse of FIRREA authority.** Chairman Issa noted that the threat of a FIRREA investigation could impose reputational risk on a bank, and that the DOJ appeared to be creating "an indiscriminate dragnet that is wholly decoupled from any concrete suspicion of fraud." He also highlighted Joel Sweet's admission that banks were being targeted for reasons of DOJ manpower efficiency, a revelation he called "stunning in its candor."
    - **Targeting of the online lending industry.** Issa contrasted the DOJ's stated desire to combat fraud only with its other statements about the online payday lending industry. He also quoted a press release from the National Bank of California that noted that certain DOJ inquiries were "part of an industry-wide DOJ investigation of ACH services provided to payday lenders." The Chairman concluded, "The use of § 951(d) subpoena power to eliminate a legitimate and legal financial service, rather than to combat actual fraud, is a significant abuse of the Department's FIRREA authority"[51]
- Also in January, Assistant Attorney General Stuart Delery wrote to American Bankers Association Chairman Jeff Plagge and Electronic Transaction Association CEO Jason Oxman to "make clear that the aim of these efforts [the Operation] is to combat fraud. The Department has no interest in pursuing or discouraging lawful conduct." Delery also pointed to the FDIC guidance that stated that, "Facilitating payment for merchant customers can pose risks to financial institutions and requires due diligence and monitoring…Financial institutions that properly manage these relationships and risks are neither prohibited nor discouraged from providing payment services to customers operating in compliance with applicable federal and state law."[52]

- On January 24, 2014, Principal Deputy Assistant Attorney General Peter Kadzik responded to Issa's letter, asserting:

  The FIRREA investigations described in your letter relate to the basic principle that a financial institution should not profit from its decision to process fraudulent transactions in violation of federal law…We want to clarify that the Department does not target

businesses operating within the bounds of the law.[53]

- In April 2014, the House Financial Services Committee solicited evidence on licensed money services businesses having their accounts terminated apparently due to pressure from Operation Choke Point. A sample of those received between December 2013 and March 2014 was included in the House report:
    - **Bank of Hawaii:** "Bank of Hawaii has made a business decision to close your above-referenced business deposit accounts. The primary reason for this account closure is the Bank's increasing business expenses involved with servicing this type of account for a customer that operates as a money service business and/or payday lender." (December 6, 2013).
    - **Bank of America:** "[W]e reviewed the nature of your business in light of current regulatory trends affecting your industry. After careful consideration we've decided to close your existing Small Business checking account ... ." (January 14, 2014)
    - **Hancock Bank | Whitney Bank:** "We are unable to effectively manage your Account(s) on a level consistent with the heightened scrutiny required by our regulators for money service businesses due to the transactional characteristics of your business." (February 26, 2014)
    - **Fifth Third Bank:** "During recent reviews of the payday lending industry, we have determined that the services provided by clients in this industry are outside of our risk tolerance. As such, we will no longer be able to provide financial services to businesses that operate in that industry." (March 18, 2014)[54]

- The developing harm inflicted by Operation Choke Point on smaller banks led the Independent Community Bankers Association to write to Assistant Attorney General Stuart Delany in April 2014, saying:

    While preventing fraud is a top concern for community banks, it needs to be balanced with ensuring that businesses and consumers that operate in accordance with applicable laws can still access payment systems … ICBA requests that the DoJ suspend Operation Choke Point immediately and focus its resources directly on businesses that may be violating the law, rather than targeting banks providing payment services. DoJ should also allow the marketplace to further implement a coordinated, targeted approach to controlling fraud and bad actors.[55]

Operation Choke Point's chilling effect was attracting national attention.

Former FDIC Chairman William Isaac called the Operation "alarming and repugnant." He said Choke Point "is a direct assault on the democratic system and free-market economy."

- By this time (April 2014), Operation Choke Point's chilling effect was attracting national attention. An April 11, 2014 *Washington Post* news story told the tale of one small payday lender who was forced out of the business when his bank ended its relationship with him:

  Al LePage has been issuing payday loans out of a suburban Minneapolis storefront for most of the past decade. But on Valentine's Day, a Wells Fargo banker called and gave him 30 days to cease and desist—or risk losing his bank account.

  "The only explanation I got was since they're not doing payroll advances anymore, they didn't want to have customers providing similar loans," said LePage, owner of Al'$ Check Cashing. "But I run a legal business."…

  Doing business with companies that inflict such harm could damage a bank's reputation and leave it vulnerable to litigation, regulators have said.

  But LePage, of Al'$ Check Cashing, said not every short-term lender takes advantage of people. He said his company charged, at most, $26 for a $350 loan. And although many customers did roll one loan into another—a practice that can trap consumers in debt—LePage said he monitored such activity and made the risks clear.

  "We've never had a complaint filed against us, because we treat our customers fairly," he said. "Shutting down our payday line just means a lot of people will either have no access to money they need or they'll go online, which isn't any better."

  After he got the call from Wells Fargo, LePage said he complained to the state attorney general and the Commerce Department, as well as the bank's chief regulator.

  Wells Fargo declined to comment on LePage's case. But spokesman Jim Seitz said bank officials "recognize the need for an extra level of review and monitoring to ensure these customers do business in a responsible way."

  In the end, LePage said he gave up and shut his payday business down.

  "Because I'm licensed through the state of Minnesota, I have to have my rates posted on the wall, and any banker that came in to visit could see them and cut me off," LePage said. "I don't want to take that chance."[56]

- Because of these concerns, former FDIC Chairman William Isaac penned accused Operation Choke Point of being "way out of control" in an April 22 opinion piece in *American Banker*. Citing a termination letter from a large bank to a large diversified

financial services corporation, he called the Operation "alarming and repugnant." He said Choke Point "is a direct assault on the democratic system and free-market economy that have made the United States the most powerful and prosperous nation in world history. Without color of law and based on a political agenda, unelected bureaucrats at the Department of Justice are coordinating with some bank regulators to deny essential banking services to companies engaged in lawful business activities. Bankers operating under the yoke of an oppressive regulatory regime are being cowed into compliance."[57]

- In an April 25 op ed in *The Hill*, Electronic Transaction Association CEO Jason Oxman decried the logic of targeting payment companies that stood to lose out by working with fraudulent merchants:

  > But far from being complicit in such fraud, payments companies share a strong interest with law enforcement in ensuring that fraudulent merchants are barred from our payments systems. Indeed, because consumers are 100 percent protected against fraud, it is the payments companies that take on the risk and liability of fraudulent merchant behavior. Because of this shared distaste for fraud, payments companies are better partners to law enforcement than targets.

- On the same day as Oxman's article, American Bankers Association President (and former U.S. Attorney and Deputy Attorney General) Frank Keating wrote in *The Wall Street Journal* that DOJ was "blurring… boundaries and punishing the banks that help them fight crime. If a bank doesn't shut down a questionable account when directed to do so, Justice slaps the institution with a penalty for wrongdoing that may or may not have happened. The government is compelling banks to deny service to unpopular but perfectly legal industries by threatening penalties."[58]

- Also in April, other stories began to surface of other "high-risk" industries beyond payday lending being hit with bank terminations owing to their nature. Porn star Teagan Presley and others in her industry had their accounts closed by Chase for that reason.[60]

- The firearms sales industry also reported significant effects on its members. On May 18, *The Washington Times* reported the following bank terminations apparently linked to the FDIC guidance:[61]
  - In April, BankUnited N.A., dumped the online business of Miami-based Top Gun Firearms Training & Supply. Top Gun owner T. R. Liberti received an explanatory email from the bank that said: "This letter in no way reflects any derogatory reasons

American Bankers Association President (and former U.S. Attorney and Deputy Attorney General) Frank Keating wrote in The Wall Street Journal *that DOJ was "blurring… boundaries and punishing the banks that help them fight crime."*

for such action on your behalf. But rather one of industry. Unfortunately your company's line of business is not commensurate with the industries we work with."

- In May, Black Rifle Armory in Henderson, Nevada, had its bank accounts frozen as the bank tried to determine whether any of Black Rifle's online transactions were suspicious.
- In 2012, Bank of America, the country's largest banking institution, suddenly dropped the 12-year account of McMillan Group International, a gun manufacturer in Phoenix—even though the company had a good credit history, the owner said—as well as the account of gun parts maker American Spirit Arms in Scottsdale, Arizona. "This seems to be happening with greater frequency and to many more dealers," said Joe Sirochman, owner of American Spirit Arms. "At first, it was the bigger guys—gun parts manufacturers or high-profile retailers. Now the smaller mom-and-pop shops are being choked out, and they need their cash to buy inventory. Freezing their assets will put them out of business."

- On May 29, a House Oversight Committee staff report criticized Operation Choke Point on several grounds:[62]
  - **Lack of adequate legal justification in its use of FIRREA.** The report argues that FIRREA was enacted to protect banks from fraud. It states, "[T]he Department's analysis clearly reflects the inherent legal error of using an anti-*bank fraud* statute to combat *merchant fraud*."[63] It concludes, "Ultimately the Department's tortured legal analysis has turned FIRREA on its head: Section 951 was intended to help the Department defend banks from fraud; instead, the Department is using it to forcibly conscript banks to serve as the "policemen and judges" of the commercial world."[64]
  - **Targeting the entire payday lending industry, including legitimate organizations, despite public assurances to the contrary.**
  - **Driving banks to terminate relationships with legitimate businesses, leaving them with no recourse.**
  - **Frustrating Congressional oversight by dismissing concerns from lawmakers.** As the staff report said regarding evidence that DOJ officials were indeed targeting payday lenders *en masse*: "It is entirely

unacceptable for the Department to formally accuse Members of Congress of 'misunderstanding' the focus of a major Department initiative, when senior officials in charge of that initiative shared precisely the same understanding."[64]

- On the same day as the report was issued, the House voted by voice vote to stop all federal funding for Operation Choke Point.[65]
- On June 5, 2014, the Community Financial Services Association of America and Advance America, Cash Advance Centers, Inc., filed suit in Federal Court against FDIC, OCC, and the Federal Reserve, for declarative and injunctive relief in respect of damages incurred resulting from Operation Choke Point. The suit alleges that the agencies' actions
    - Were without observance of procedure required by law;
    - Exceeded their statutory authority;
    - Were arbitrary and capricious; and
    - Violated the plaintiffs' due process rights.

In particular, the lawsuit alleges that the agency guidance applies to the payday lending industry as a whole, does not give sufficient advice on how to distinguish between a lawful enterprise and a fraudulent one, and therefore unfairly stigmatizes lawful payday lenders, injuring their reputations.[66]

Problems and Policy Recommendations

Overzealous Pursuit of Fraud by Federal Officials

While Operation Choke Point seems to have its origins in the worthy goal of tackling payment processor fraud, it has done nothing to protect consumers and has gone a long way to undermine the rule of law.

Operation Choke Point has done nothing to protect consumers and has gone a long way to undermine the rule of law.

Federal officials, especially prosecutors, wield significant powers they may exercise in the public interest. Therefore, it is incumbent on them to show restraint in the use of those powers. At every point in the decision making process of exercising these powers, feedback loops need to be in place to ask whether continuing action is appropriate. The internal DOJ memos and reports relating to Operation Choke Point clearly show that concerns that should have given pause—for example, over the burden placed on legal businesses having to prove their legality and trustworthiness—were dismissed as detrimental to the mission.

Furthermore, oversight by senior Department of Justice officials appears to have been nonexistent. The House Oversight Committee received no critical—or any other—responses indicating concerns about the operation

It is not appropriate for a regulator to attempt to define reputational risk.

from senior officials in the documents provided by the Department of Justice.

Policy Recommendation: The Department of Justice's Office of the Inspector General should undertake an immediate investigation into the appropriateness of actions by officials at all levels relating to Operation Choke Point. If such an investigation does not happen, Congressional oversight bodies should demand it. Congress should hold hearings and ask senior officials about the appropriateness of their subalterns' actions.

Reputational Risk

The motivation behind the FDIC's involvement in Choke Point—and the chilling effect detailed below on other industries— has been the agency's concern about "reputational risk." It is not appropriate for a regulator to attempt to define reputational risk. Such a judgment is best left up to an individual bank, which will have a much better idea of the risks involved in its relationships with its clients than would a third party such as a regulator. The FDIC's interest stems from its role in insuring the accounts of depositors with banks, and as such was increased when deposit insurance was raised from $100,000 per account to $250,000 during the financial crisis.

Policy Recommendation: Congress should lower the deposit insurance limit back from $250,000 to $100,000 at most. This would reduce FDIC's exposure and therefore reduce its concerns about banks that may be inappropriate relationships.

Self-Fulfilling Prophecy

The main question regarding the appropriateness of Operation Choke Point is whether the "red flags" and "warning signs" used by the DOJ and FDIC to designate a business as potentially fraudulent are appropriate when dealing with businesses that have an intrinsic higher rate of returned items owing to the nature of the business (payday lending being primarily used by poor people) or to a degree of shame involved (payments to porn businesses being discovered by a spouse) or whether these apply at all (long-established gun businesses being designated "high risk" for seemingly no reason). Indeed, a high rate of return can be a sign of fraud *against* a business, not by it.

If some industries will naturally have a return rate of 3 percent of higher, then some further test is needed to designate whether they are potentially fraudulent or not. Yet, the criteria used by Operation Choke Point appear to form a self-fulfilling prophecy. Undoubtedly some processors and merchants that generate extraordinarily high rates of returns should require extra scrutiny. But the DOJ's 3 percent threshold seems too low for a campaign targeted at the worst offenders. Instead, it appears to be more of a fishing expedition aimed at finding potential offenders who might very well be legitimate businesses.

Another warning sign specifically related to payday lending, annual percentage rate, is clearly inappropriate. Translating an origination fee for a short-term loan into a putative APR is using a tool designed for assessing long term lending in a way for which it was not designed. As CEI's John Berlau has noted, "The 400-percent interest rate is the financial equivalent of a unicorn, yet it has driven public policy regarding short-term credit with destructive results for the neediest of borrowers."[67] Using this as a "red flag" is another self-fulfilling prophecy.

Policy Recommendation: FDIC and other regulators should collaborate with payment processors and specifically the payday lending industry to develop a realistic set of indicators of fraud within designated high-risk industries rather than worrying about indefinable generalities like reputational risk. Congress can direct the regulators to do this by amending the Dodd-Frank Act with more specific language.

Chilling Effect

Operation Choke Point has had a demonstrable chilling effect on commerce. Banks are already highly regulated. The burden of regulation is such that small and mid-size banks around the country are merging to deal with the compliance costs. Most such banks cannot afford the extra supervision that comes with a Choke Point subpoena, whether they believe their clients are legitimate or not. Thus, they often face no other choice but to drop payment processors and designated "high-risk" clients altogether. Yet, as noted, the idea that banks would do this appears to have been the main rationale behind Operation Choke Point in the first place.

This chilling effect has a possible further regrettable consequence seen in the response to UIGEA. Businesses that have no legitimate recourse are presented with a choice: Shut down or skirt the law. Some previously legitimate businesses may be tempted to take the course taken by certain online gaming companies and work to hide their activities. If so, Operation Choke Point will have encouraged fraud rather than deterred it.

Finally, there is one other group left with no recourse: customers. In the case of payday lenders, their customers are often "unbanked" and have no viable credit rating. They will therefore be tempted to seek out dubious or even illegal loan sources. Similarly, gun and ammunition purchases may increasingly be done off the books. The porn industry has only recently stepped out of the shadows, and it would be extremely negative for performers and customers to push it back into the shadows.

Policy Recommendation: DOJ and other regulators should cease use of FIRREA subpoenas and use other investigative methods that are less burdensome on banks. Congress can amend FIRREA to clarify that its purpose is to prevent fraud against banks. Amending Dodd-Frank to

Businesses that have no legitimate recourse are presented with a choice: Shut down or skirt the law.

provide clear definitions of what constitutes fraud in payday lending would also help mitigate the current uncertainty.

It was not a bug, but a feature of Operation Choke Point's original proposal to force banks to do the investigators' work for them.

Inappropriate Deputizing

It was not a bug, but a feature of Operation Choke Point's original proposal to force banks to do the investigators' work for them by scrutinizing their customers' business methods for potential criminal violations. While due diligence is to be expected from banks, criminal investigative duties are not. The list of actions required of banks when dealing with high-risk customers outlined in the original FDIC guidance is extremely burdensome, to say nothing of the extra investigation required when in receipt of a FIRREA subpoena.

Shifting the costs onto supervised bodies is not an acceptable principle of governance. If government feels it needs to undertake a program, it should make the case for it through the appropriate legislative channels. Businesses need to be allowed to make their own business decisions without the threat of being required by their regulators to do their job for them.

Policy Recommendation: The Attorney General should request funds from Congress through the appropriations process for enhanced fraud deterrence if he believes it is a priority. Until such funds are granted, his officials should use other less burdensome methods as suggested above.[68] The FDIC and other regulators should consider the constitutional implications of their guidance on high-risk industries and revise accordingly. Congress should refuse to allow any funds to be used for Operation Choke Point until it agrees to such a request from the Administration. Amendments to Dodd-Frank and FIRREA as suggested above should also make clear that deputizing third parties is not an appropriate regulatory action.

Precedent

The FDIC's list of high-risk industries seems arbitrary, guided more by moral censure than by any real prospect of criminality. If "reputational risk" is indeed a significant factor in designating an industry "high risk," then it is not too difficult to imagine a future FDIC in more "conservative" times designating a whole different list of industries (although one imagine that poor old pornography will make both lists). For instance, otherwise legal marijuana sellers might make the list (they are quite conspicuous by their absence today). So might abortion providers.

Policy Recommendation: If FDIC continues to believe a list of high-risk industries is necessary after all the other recommendations outlined above are taken on board, it should work to ensure that the reasons for an industry's inclusion are outlined in a clearly objective fashion.[70]

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65 Ibid., p.11.
66 Kelly Riddell, "House votes to defund Justice Dept. program that targeted legitimate gun dealers," *Washington Times*, May 30 2014, http://www.washingtontimes.com/news/2014/may/30/house-votes-to-defund-doj-program-that-snagged-leg/.

67 *CFSAA and Advance America v. FDIC, Board of Governors of the Federal Reserve, OCC*, and *Thomas J. Curry, U.S. District Court for the District of Columbia, Civil Action No. 14-953*, filed June 5, 2014.

68 Berlau.

69 CEI counsel Hans Bader has drawn attention to the constitutional implications of the FDIC's targeting of certain industries despite their high-risk designation:

"I wonder how the Justice Department claims to reconcile these chilling investigations with the First or Second Amendments. The First Amendment can be violated by deliberately burdensome investigations, even in the civil context, when the investigation is aimed at a category of speech or speakers, see, e.g., *White v. Lee*, 227 F.3d 1214 (9th Cir. 2000) (unduly prolonged federal fair-housing investigation violated First Amendment). Indeed, it can violate the First Amendment so clearly that individual federal officials lose their qualified immunity and can be sued individually for damages, as the Ninth Circuit ruled in the *White v. Lee* decision. And as UCLA Law Professor Eugene Volokh and firearms law expert David Kopel have noted, restrictions can violate the Second Amendment even when they are aimed at sellers, rather than purchasers, of firearms. See, e.g., *Kole v. Norridge* (2013). So there are serious constitutional issues at stake here. Yet I see little legal commentary on the subject so far.

"Even if the porn industry were to have a statistically greater incidence of financial shenanigans than would a representative cross section of the country as a whole, that would not justify the government or financial regulators in suppressing it." Hans Bader, "Operation Choke Point Targets Porn and Firearms, Potentially Violating the Constitution," CEI Openmarket blog, May 6, 2014, http://cei.org/2014/05/06/operation-choke-point-targets-porn-and-firearms-potentially-violating-the-constitution.

70 The FDIC has appeared to agree that no specific list of industries is necessary, by withdrawing the list on July 28. However, FDIC's guidance about reputational risk remains fundamentally unchanged, and it could be that future versions of the list reappear, or that the received wisdom in the regulated community is that the list remains a good guide to what FDIC and/or DOJ might pay attention. FDIC, "FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors," press release, July 28, 2014, http://www.fdic.gov/news/news/financial/2014/fil14041.html.

About the Author

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