

OPERATION CHOKE POINT

Operation Choke Point is a Department of Justice-led initiative based on guidance from the Federal Deposit Insurance Corporation aimed at “choking off” the financial oxygen to certain industries designated as “high risk” for fraud. It is an example of executive overreach, as it abuses existing powers for purposes never intended by Congress. As a result, it has turned into both an extensive fishing expedition that has caused many legal businesses to lose banking services and a vehicle for bypassing the legislative process to shut down politically disfavored industries.

Congress should:

- ◆ Amend the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) to prevent its abuse by politically motivated prosecutors.
- ◆ Reform the Bank Secrecy Act to provide less room for regulatory overreach.
- ◆ Remove all funding for Operation Choke Point.
- ◆ Amend Dodd-Frank to provide specific guidance on what constitutes, and does not constitute, fraud in payday lending to prevent regulatory abuse.

Operation Choke Point is ostensibly a joint effort by various regulatory entities—the Department of Justice, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation 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 those industries. CEI’s *Issue Analysis* “Operation Choke Point: What It Is and Why It Matters” provides detailed background on how Operation Choke Point began and what it has turned into.

However, that seemingly laudable aim conceals a worrying reality. There is nothing illegal about most of those industries (at least not yet). However, 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 that significant chilling effect, of which the primary victims are the customers of legal businesses that become unable to access financial services. In some cases, that chilling effect will push customers of the now-unobtainable service toward illegal providers, with subsequent risks to their health, liberty, or both.

The Department of Justice’s main tool for its overzealous investigation has been subpoenas issued under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989—a statute that was not designed to prosecute consumer fraud, but rather fraud against banks. As a result, it allows for much greater damage awards than other more appropriate statutes for investigation and penalties, such as the Federal Deposit Insurance Act and the Federal Trade Commission Act. That higher level of potential damages for which banks might be found liable is a likely reason for banks to sever ties with potential “high-risk” customers. Congress should amend FIRREA to clarify that it is not intended for use in cases of consumer fraud.

The Department of Justice and its allies have used the Bank Secrecy Act’s reporting provisions to compel banks to provide information on their customer activities that go well beyond anything authorized by normal legislative or regulatory authority. The Bank Secrecy Act should ideally be repealed, or at the very least amended, to place strict bounds on what regulators may require of banks—preferably requiring evidence of wrongdoing in order to be allowed to begin a criminal investigation.

Operation Choke Point began with executive branch agencies acting on their own, without authorization from Congress. Therefore, Congress should use the power of the purse to curtail this rogue operation. The House of Representatives has already passed a motion defunding the operation, and that should be a priority in the new Congress.

One of Operation Choke Point's primary targets has been the payday loan industry, even though the Dodd-Frank Act specifically exempted the industry from such regulatory constraints as interest rate caps. Nevertheless, financial regulators have taken such high annual percentage rate (APR) equivalents as de facto indicators of fraud, an approach that is completely inappropriate for payday loans, which are extremely short-term by definition. Therefore, Congress should amend Dodd-Frank to state in its instructions to regulators that high APR equivalents are not themselves indicators of fraud and should not be construed as such. Similar provisions should also apply to such indicators as high "recharge" rates (payments refused by the customer's bank), to which the payday loan industry is particularly susceptible.

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For Further Reading

Alden Abbott, "Choking Off' Disfavored Businesses and Their Clients: How Operation Choke Point Undermines the Rule of Law and Harms the Economy," Legal Memorandum No. 133, Heritage Foundation, August 4, 2014, <http://www.heritage.org/research/reports/2014/08/choking-off-disfavored-businesses-and-their-clients-how-operation-choke-point-undermines-the-rule-of-law-and-harms-the-economy>.

Iain Murray, "Operation Choke Point: What It Is and Why It Matters." *Issue Analysis* 2014 No. 1, Competitive Enterprise Institute, July 2014, <https://cei.org/content/operation-choke-point>.

Solveig Singleton, Testimony before the U.S. House of Representatives Committee on Banking and Financial Services Oversight, hearing regarding the Bank Secrecy Act and reporting requirements, April 20, 1999, <https://cei.org/outreach-regulatory-comments-and-testimony/testimony-bank-secrecy-act-and-privacy-policy>.