July 15 & 17, 2014 Operation Choke Point Hearings:

House Financial Services Subcommittee for Oversight and Investigations–Operation Choke Point Oversight Hearing

The Subcommittee included witnesses from the Department of Justice (DOJ), federal banking regulators, industry, and academia who testified before the House Financial Services and House Judiciary Committees in a series of hearings on Operation Choke Point, a DOJ initiative to ensure the payments system is not being used to facilitate fraud.

DOJ testified it does not targeting specific industries, but rather investigates specific allegations of fraud using traditional investigative techniques. Banking regulators testified they have each issued guidance which generally requires banks to assess customer risk, but particular industries are not targeted and institutions make their own businesses decisions on account management.

Bill Isaac, former FDIC Chairman testifying on his own behalf, countered Choke Point is targeting politically unpopular industries and stressed people should petition their federal and state legislatures to render particular industries illegal.

In response to a question about legal marijuana businesses accessing banking services, FDIC referenced FinCEN guidance issued in February. In response to a question about targeting banking services for coal industry participants, banking regulators stressed that is not occurring and reiterated no particular industries are targeted.

Rep. Patrick McHenry called Operation Choke Point an "ideological crusade against industries identified by the government.” The Federal Deposit Insurance Corporation, for example, listed about 30 industries that are considered to be high risks for fraudulent activity, ranging from credit repair services to telemarketing.

“This is a government hit list of industries,” said Rep. Patrick McHenry, the North Carolina Republican who chaired Tuesday’s hearing.

The FDIC, he said, is telling banks to sever ties with merchants in these industries.

The House Financial Services Committee will possibly mark-up legislation in the fall to provide a safe harbor for banks that provide banking services for lawful activities.
House Judiciary Subcommittee on Regulatory Reform

On July 17, 2014 House Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law discussed in-depth the effect of the DOJ’s Operation Choke Point on businesses considered to be in “high risk” industries that receive financial services from banks and payment processors.

Stuart Delery, the assistant attorney general with the Department of Justice, said during the hearing that investigations related to Operation Choke Point stem from evidence of fraud against consumers.

“Whether a bank either knows, or is willfully ignorant that a merchant is committing fraud or taking money from people, the DOJ will act,” Delery said in his testimony. “When any entity—whether it is a merchant, a third-party payment processor, or a bank—commits fraud against consumers, the department will not hesitate to enforce the law.”

Legislators said during the hearing the operation is harming legitimate businesses.

“There is no dispute that consumer fraud is a real phenomenon,” said House Judiciary Chairman Rep. Bob Goodlatte (R-Va.) “There is also no dispute that Operation Choke Point is cutting off some fraudster access to the banking system. The bipartisan concern is that there is an unacceptable level of collateral damage.”

Delery explained during the hearing that the DOJ has examples of “high-risk merchants” provided by the Federal Deposit Insurance Corporation that it uses for its regulatory mission. Those merchants include, for example, payday lenders, fireworks vendors or online dating services.

“The department’s mission is to fight fraud, and we recognize that an entity’s simply doing business with a merchant considered high risk is not fraud,” Delery said.

Rep. Darrell Issa hit DOJ on the substance of the subpoenas. For example, Issa noted FDIC guidance listing “high risk” industries was frequently attached to subpoenas. Cleary, Issa believe that FDIC and DOJ had been coordinating their efforts. DOJ reiterated that investigations are based on particular facts and not targeted at specific industries.

Since Operation Choke Point started, the DOJ has resolved one case stemming from a complaint that Four Oaks Bank allowed a third-party payment processor to facilitate payments for fraudulent merchants despite active and specific notice of the fraud. On April 25, 2014, the U.S. District Court for the Eastern District of North Carolina entered a consent order and approved a settlement agreed to by the department and Four Oaks Bank, according to Delery.
The DOJ has ongoing civil and criminal investigations through Operation Choke Point. The department has issued 50 subpoenas related to those investigations, Delery said.

Some members of the subcommittee said those subpoenas alone are deterring banks from continuing to work with businesses listed in the documents.

“This is having the effect of shutting down these companies, whether than was intended or not,” said subcommittee chairman Rep. Spencer Bachus (R-Ala.)

Delery stressed that the DOJ bases its investigations on evidence of fraudulent activity, not actions of a whole industry.

“We’re holding institutions accountable for their own misconduct … not the misconduct of anybody else,” he said.