

U.S. House of Representatives
Committee on Oversight and Government Reform

Darrell Issa (CA-49), Chairman

**Jim Jordan (OH-04), Chairman, Subcommittee on Economic Growth,
Job Creation and Regulatory Affairs**



**Federal Deposit Insurance Corporation's Involvement in
"Operation Choke Point"**

Staff Report
113th Congress

December 8, 2014

Key Findings

- The Federal Deposit Insurance Corporation, the primary federal regulator of over 4,500 banks, targeted legal industries. FDIC equated legitimate and regulated activities such as *coin dealers* and *firearms and ammunition sales* with inherently pernicious or patently illegal activities such as Ponzi schemes, debt consolidation scams, and drug paraphernalia.
- FDIC achieved this via “circular argument” policymaking: there was no articulated justification or rationale for the original list of “high-risk merchants.” Yet a list of “potentially illegal activities” included in FDIC’s formal guidance to banks justified itself by claiming that the categories had been previously “noted by the FDIC.”
- FDIC’s explicitly intended its list of “high-risk merchants” to influence banks’ business decisions. FDIC policymakers debated ways to ensure that bank officials saw the list and “get the message.”
- Documents produced to the Committee reveal that senior FDIC policymakers oppose payday lending on personal grounds, and attempted to use FDIC’s supervisory authority to prohibit the practice. Personal animus towards payday lending is apparent throughout the documents produced to the Committee. Emails reveal that FDIC’s senior-most bank examiners “literally cannot stand payday,” and effectively ordered banks to terminate all relationships with the industry.
- In a particularly egregious example, a senior official in the Division of Depositor and Consumer Protection insisted that FDIC Chairman Martin Gruenberg’s letters to Congress and talking points always mention *pornography* when discussing payday lenders and other industries, in an effort to convey a “good picture regarding the unsavory nature of the businesses at issue.”
- FDIC actively partnered with Department of Justice to implement Operation Choke Point, and may have misled Congress about this partnership.

I. Background on Operation Choke Point

Over the past year, the Committee on Oversight and Government Reform has been investigating a federal initiative forcing banks to terminate relationships with businesses deemed “high-risk” by federal regulators. Within the Department of Justice, this initiative is known as “Operation Choke Point.” Pursuant to a January 8, 2014 request by Chairman Issa and Subcommittee Chairman Jordan, the Justice Department produced 853 pages of internal memoranda, communications, and presentations on Operation Choke Point.¹ On May 29, 2014, the Committee released a staff report on the preliminary findings of its investigation.² The report offered three primary conclusions:

1. Operation Choke Point is an abuse of the Department’s statutory authority.
2. While broadly concerned with all industries deemed “high risk,” the initiative is particularly focused on payday lending.
3. As a consequence of Operation Choke Point, banks are indiscriminately terminating relationships with legal and legitimate merchants across a variety of business lines.

This final conclusion is incontrovertible: documents produced by the Justice Department reveal that senior DOJ officials directly informed the Attorney General that as a result of Operation Choke Point, banks are “exiting ‘high-risk’ lines of business.”³

Documents produced to the Committee reveal that DOJ actively partnered with the Federal Deposit Insurance Corporation in the prosecution of Operation Choke Point. FDIC is the primary federal regulator of state-chartered banks that are not members of the Federal Reserve System, and directly supervises and examines more than 4,500 depository institutions.⁴ FDIC’s participation in Operation Choke Point included requests for information about the investigation, discussions of legal theories and the application of banking laws, and the review of documents involving FDIC-supervised institutions obtained by DOJ in the course of its investigation.⁵ Furthermore, FDIC originated the list of “high risk” industries included in the DOJ subpoenas.⁶

¹ Letter from Darrell Issa, Chairman, H. Comm. on Oversight and Gov’t Reform, and Jim Jordan, Chairman, Subcomm. on Economic Growth, Job Creation and Regulatory Affairs of the H. Comm. on Oversight and Gov’t Reform, to Eric H. Holder, Jr., Att’y Gen., U.S. Dep’t of Justice, Jan. 8, 2014; STAFF OF THE H. COMM. ON OVERSIGHT AND GOV’T REFORM, 113TH CONG., REPORT ON THE DEPARTMENT OF JUSTICE’S “OPERATION CHOKE POINT”: ILLEGALLY CHOKING OFF LEGITIMATE BUSINESSES? (May 29, 2014).

² *Id.*

³ E-mail from the Chief of Staff, Civil Division, U.S. Dep’t of Justice, to the Assistant Attorney General, Civil Division, U.S. Dep’t of Justice (Nov. 18, 2013, 20:51) (containing briefing points on Operation Choke Point for the Attorney General), HOCR-3PPP000458.

⁴ Federal Deposit Insurance Corporation, Who is the FDIC?, *available at* <https://www.fdic.gov/about/learn/symbol/>.

⁵ *The Department of Justice’s “Operation Choke Point”: Hearing before Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Services*, 113th Cong. (July 15, 2013) (written statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation).

⁶ *Guilty Until Proven Innocent? A Study of the Propriety & Legal Authority for the Justice Department’s Operation Choke Point: Hearing before the H. Comm. On the Judiciary*, 113th Cong. (Jul. 17, 2014) (statement of Stuart F. Delery, Assistant Att’y Gen., Civil Division, U.S. Dep’t of Justice, in response to a question from Rep. Darrell Issa).

In a letter to FDIC Chairman Martin J. Gruenberg on June 9, 2014, Chairman Issa and Subcommittee Chairman Jordan requested documents and communications concerning FDIC’s role in Operation Choke Point and its supervisory policies with respect to “high risk” merchants. FDIC cooperated with the Chairmen’s request, providing over 7,500 pages of internal communications, memoranda, and official correspondence with supervised institutions. The documents implicate deep failures in FDIC supervisory and examination policy, the consequence of which has been to foreclose bank access to legal and legitimate merchants.

II. FDIC’s Delineation of “High Risk Merchants”

FDIC publishes *Supervisory Insights*, a quarterly journal intended to serve as informal and educational guidance for both FDIC examiners and private sector stakeholders.⁷ The summer 2011 issue of *Supervisory Insights* included the article “Managing Risks in Third-Party Payment Processor Relationships.”⁸ The ostensible purpose of the article is to advise financial institutions on how to adequately monitor and manage the risks associated with payment processors and their merchant clients. The article argues that “[a]lthough 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 for questionable or fraudulent goods and services.”⁹ The article identified the following industries as “high-risk”.¹⁰

Some merchant categories that have been associated with high-risk activity include, but are not limited to:

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

⁷ See, e.g., E-mail from FDIC Deputy Regional Director to FDIC officials (Apr. 17, 2011, 09:37) (“Step one is the article for the Supervisory Insights Journal which goes out to bankers and examiners”), FDICHOG00002582.

⁸ Michael Benardo, Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, Federal Deposit Insurance Corporation, et al., *Managing Risks in Third-Party Payment Processor Relationships*, 8 SUPERVISORY INSIGHTS 3 (Summer 2011).

⁹ *Id.* at 6.

¹⁰ *Id.* at 7.

While the article provided no explanation for the inclusion of any single identified merchant category, it did offer four criteria associated with high-risk activity: 1) the consumer's lack of familiarity with the merchant, 2) uncertainty with respect to the quality of goods and services being offered, 3) online or telephonic sales, and 4) the consumer's ability to verify the identity or legitimacy of the merchant.¹¹ However, these vague standards provide no explanation for the implicit equation of such legitimate and regulated activities as *coin dealers* and *firearms and ammunition sales* with inherently pernicious or patently illegal activities such as Ponzi schemes, racist materials, or drug paraphernalia.

Documents produced to the Committee record the months-long internal deliberations and multi-tiered review of the *Supervisory Insights* article. Unfortunately, these documents reflect the total absence of a critical review of the high-risk merchant list. Preliminary drafts of the article were subject to an intensive agency-wide review process.¹² No official in FDIC's Division of Depositor and Consumer Protection, Division of Risk Management Supervision, the Legal Division, or the Office of the Chairman inquired into or commented on the list or on the inclusion of any particular merchant category. Similarly, no documents record or reference the agency's reasoning in creating the list. The lack of such a record raises the possibility it is little more than a haphazard and idiosyncratic reflection of the authors' personal opinions.

Furthermore, documents produced to the Committee reveal that FDIC officials explicitly intended the list to influence the FDIC examination process. In one email exchange, senior officials at FDIC headquarters request that an Assistant Regional Director join as a co-author of the article, in an effort to ensure that the list "gets attention by both [Risk Management] and [Depositor and Consumer Protection] examiners."¹³ Offering feedback on the article, one Regional Office explicitly focused on how the high-risk merchant list would influence the examination process: "we believe the articles will assist examiners and others in understanding the broad risk considerations that are present **in these business lines** and will help focus more detailed analysis during examinations."¹⁴ [emphasis added]

Following publication of the *Supervisory Insights* article, FDIC staff began the process of formalizing its prescripts into an official guidance document, known as a Financial Institution Letter (FIL).¹⁵ FILs are understood by supervised institutions to be the formal policy of the FDIC, and are interpreted by bank compliance and legal officers as tantamount to compulsory

¹¹ *Id.* at 6.

¹² The author circulated the first draft in March 2011. See E-mail from Chief, Cyber-Fraud and Financial Crimes Section, Division of Risk Management Supervision, to Managing Editor, *Supervisory Insights*, Division of Risk Management Supervision (Mar. 30, 2011, 22:45), FDICHOGR00002079. FDIC published the summer 2011 issue of *Supervisory Insights* on July 14, 2011.

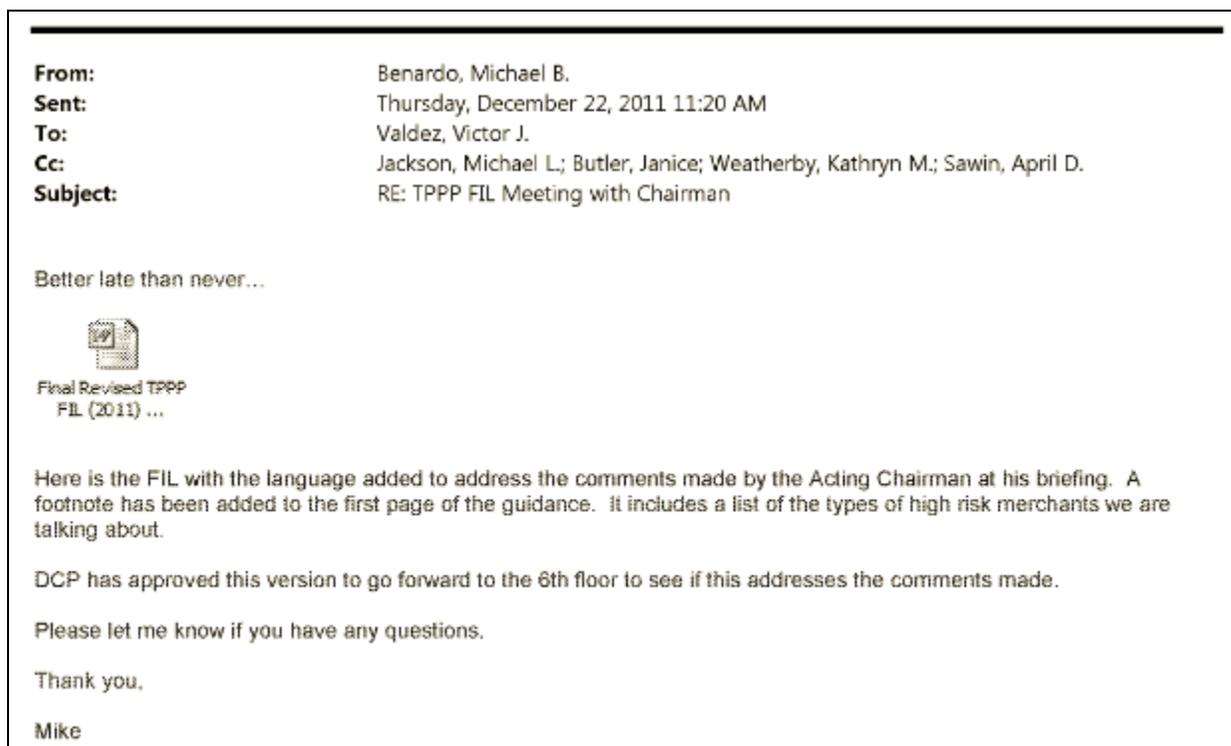
¹³ E-mail from Chief, Cyber-Fraud and Financial Crimes Section, Division of Risk Management Supervision, to an Assistant Regional Director, Division of Depositor and Consumer Protection (Apr. 5, 2011, 15:33), FDICHOGR00002011.

¹⁴ E-mail from Charlotte Territory Supervisor, on behalf of Atlanta Regional Director Thomas Dujenski, to the Managing Editor of *Supervisory Insights* at FDIC headquarters (May 8, 2011, 21:06), FDICHOGR00002644.

¹⁵ E-mail from FDIC Deputy Regional Director to FDIC officials (Apr. 17, 2011, 09:37) ("Step one is the article for the *Supervisory Insights* Journal . . . Step two is a Financial Institution Letter which should be east to prepare now that the article is draft."), FDICHOGR00002582.

rules.¹⁶ The earliest drafts of the FIL did not contain an enumerated list of high-risk merchants: an early draft from June 2011 does not specify any particular industry for heightened scrutiny.¹⁷ However, by September 2011, a footnote appears on page 4: “Businesses with elevated risk may include offshore companies, online gambling-related operations, and online payday lenders. Other businesses with elevated risks include credit repair schemes, debt consolidation and forgiveness, pharmaceutical sales, telemarketing entities, and online sale of tobacco products.”¹⁸

In November 2011, FDIC staff briefed then-Acting Chairman Gruenberg on the proposed FIL.¹⁹ Documents produced to the Committee reveal that the Acting Chairman himself explicitly instructed FDIC staff to expand and emphasize the list of targeted industries.²⁰



Further communications reveal the extraordinary significance that Chairman Gruenberg and FDIC staff attached to the high-risk merchants list. One official attempted the extremely unusual step of including the list on the FIL’s *cover page*, in an effort to “grab some attention.”²¹ The

¹⁶ Federal Deposit Insurance Corporation, Financial Institution Letters, *available at* <https://www.fdic.gov/news/news/financial/>.

¹⁷ June 2011 draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002128.

¹⁸ September 2011 draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002033.

¹⁹ E-mail from a Senior Examination Specialist, Div. of Depositor and Consumer Protection, to the Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, FDICHOGR00002173.

²⁰ E-mail from Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, to the Deputy Director, Div. of Risk Management Supervision, FDICHOGR00002183.

²¹ E-mail from a Senior Examination Specialist, Div. of Depositor and Consumer Protection, to the Chief, Cyber-Fraud and Financial Crimes Section, Div. of Risk Management Supervision, FDICHOGR00002173.

official even expressed concern about “putting anything later in the document as the reader **may not get the message.**”²² [emphasis added]

From: Bowman, John B.
Sent: Tuesday, November 15, 2011 9:46 AM
To: Benardo, Michael B.
Subject: TPPP FIL

Hi Mike:

I edited the FIL based on the recommendations from yesterday's briefing. I toyed with the idea of including a footnote on the first page but as you can see it moves things to the second page. So, I'm not so sure this is a workable solution. I also included a footnote on the second page, which is still upfront and should grab some attention. I'm just concerned with putting anything later in the document as the reader may not get the message. In any event, this is a starting point. Let me know what you think. Thanks.

<< File: Final Revised TPPP FIL (11-15-2011).doc >>

Regards,

John B. Bowman
Review Examiner - Washington Office

Following the Chairman's orders to explicitly include and emphasize the list of high-risk merchants, a December 2011 draft of the FIL included the following footnote on page 1:

Example of telemarketing and online merchants that have displayed a higher incidence of consumer fraud or potentially illegal activities noted by the FDIC include: credit repair services, gambling, government grant or will writing kits, pay day or sub-prime loans, pornography, tobacco or firearm sales, sweepstakes, and magazine subscriptions. This list is not all-inclusive. The risks presented by each relationship must be measured according to its own facts and circumstances. While some of these activities might be legitimate, financial institutions should be aware of the increased risks associated with payments to such merchants.²³

The circularity of the FDIC's policymaking is immediately apparent. As noted above, FDIC had no articulated rationale for including the “high risk” merchants list in the *Supervisory Insights* article.²⁴ Yet the FIL's footnote of “potentially illegal activities” justifies itself by claiming that the categories had been previously “noted by the FDIC.”²⁵

While the targeting of any legal industries is in and of itself pernicious, the qualifying language in the December 2011 draft demonstrates a modicum of restraint, and recognizes that the listed merchant categories are not inherently illegal or fraudulent. Unfortunately, the final draft of the FIL flatly rejected such restraint. The final release approved by Chairman Gruenberg stripped the language advising banks to manage each relationship “according to its own facts and circumstances,” as well as the language

²² *Id.*

²³ Dec. 2011 draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002185.

²⁴ See text accompanying *supra* note 12.

²⁵ See *supra* note 23.

recognizing that merchants in the named categories may be legitimate.²⁶ Such a revision calls into question FDIC’s assertions that it is merely advising banks to adopt reasonable “know your customer” due diligence standards, and lends credence to the argument that it is effectively proscribing the enumerated activities.

It is difficult to understate the significance and impact of the high-risk merchant list. In addition to influencing both regulators’ examination policy and banks’ private business decisions, the list was often directly incorporated into FDIC-mandated Memorandums of Understanding (MOUs) and Consent Orders as “prohibited businesses.”²⁷ The experience of one entry on the list – firearms and ammunitions merchants – effectively traces the downstream influence of the high-risk merchants list. MOUs between supervised banks and FDIC Regional Offices, as well as bank policies submitted pursuant to FDIC Consent Orders, variously “prohibit” payment processing for firearms merchants, characterize loans to firearms dealers as “undesirable,” and generally subject firearms and ammunitions merchants to significantly higher due diligence standards.²⁸

The inclusion of firearm merchants on the high-risk list did not just impact the behavior of FDIC supervisory and enforcement staff. A number of private companies create and sell compliance and risk management training software for bank employees; at least two companies, AML Services International and MSB Compliance, directly incorporated the FDIC list into its designation of high-risk merchant and originator categories.²⁹ One training package offered by FIS Global educates and tests bank compliance officers for “Types of Higher Risk Individuals and Non-Individuals.” The program includes the following entry:³⁰

Arms and Ammunition Dealers

Arms and Ammunition Dealers are identified as higher risk businesses because they have a higher risk of being associated with terrorism and terrorist acts.

Such spurious claims are an inherent product of the list’s opacity; in both the *Supervisory Insights* article and the Financial Institution Letter, FDIC did not justify or explain why it believes relationships with firearms and ammunition merchants present a “high risk” to supervised financial institutions.

²⁶ Jan. 31, 2011 final draft of Financial Institution Letter concerning Payment Processor Relationships, FDICHOGR00002413.

²⁷ See, e.g., Letter from unnamed bank to Thomas Dujenksi, Regional Director, Federal Deposit Insurance Corporation, Aug. 1, 2013 (concerning terms of a §§ 15(a) and 15(b) Consent Order, revising the bank’s ACH policy to prohibit certain businesses; name of bank redacted by FDIC), FDICHOGR00004062.

²⁸ FDICHOGR00004097; FDICHOGR00004101; FDICHOGR00004092; FDICHOGR00004190.

²⁹ AML Services International Webinar, FDICHOGR00004147; MSB Compliance presentation, FDICHOGR00004167.

³⁰ FIS Global, AML and Sanctions, Types of Higher Risk Individuals and Non Individuals (on file with Committee staff).

III. FDIC Targeted Legal Industries

a. Officials in FDIC Headquarters were Determined to Eliminate Payday Lending

Documents produced to the Committee reveal that senior policymakers in FDIC headquarters oppose payday lending on personal grounds, and attempted to use FDIC's supervisory authority to prohibit the practice. In emails from February 2013, the Director of FDIC's Atlanta Region noted he was "pleased we are getting banks out of ach (payday, bad practices, etc). Another bank is gripping [*sic*] . . . but we are doing good things for them!"³¹ Mark Pearce, the Director of FDIC's Division of Depositor and Consumer Protection, expressed agreement with the sentiment, and noted concern over "failure to be proactive" on the issue.³²

From: Pearce, Mark (DCP)
Sent: Thursday, February 07, 2013 9:00 PM
To: Dujenski, Thomas J.
Subject: RE:

Glad we're on the same page. As you note, failure to be proactive on this will lead to enforcement agencies or reputational issues, which is not in best interest of our institutions.

Mark Pearce
Director, Division of Depositor and Consumer Protection Federal Deposit Insurance Corporation
[REDACTED]

-----Original Message-----
From: Dujenski, Thomas J.
Sent: Thursday, February 07, 2013 5:57 PM
To: Pearce, Mark (DCP)
Subject:

I am pleased we are getting the banks out of ach (payday, bad practices, etc). Another bank is gripping but we are doing good things for them! For example, the [Redacted] bank is going to hate doj being involved. We are doing the right thing for sure....one or two banks may complain next week when the florida banks come to dc as a group.

Additional documents confirm Director Pearce's opposition to payday lending, and determination to deploy FDIC's supervisory power to prohibit or discourage the practice. In an email dated February 22, 2013, a Senior Counsel in the Legal Division's Consumer Enforcement Unit informed an Assistant General Counsel there is top-level interest in stopping payday lending. The email describes how Director Pearce is interested "in **trying to find a way to stop our banks from facilitating payday lending.**"³³ [emphasis added] The Senior Counsel even describes concern with this approach, noting that other officials cautioned that "...unless we can

³¹ Email from Thomas J. Dujenski, Atlanta Regional Director, Federal Deposit Insurance Corporation, to Mark Pearce, Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation (Feb. 7, 2013 21:00), FDICHOGR00006898.

³² Email from Mark Pearce, Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation to Thomas J. Dujenski, Atlanta Regional Director, Federal Deposit Insurance Corporation (Feb. 7, 2013 21:00), FDICHOGR00006898.

³³ Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC to James L. Anderson, Assistant General Counsel, Consumer Section, Consumer, Enforcement/Employment, Insurance & Legislation Branch, FDIC (Feb. 22, 2013 11:13), FDICHOGR00006907.

show fraud or other misconduct by the payday lenders, we will not be able to hold the bank responsible.”³⁴

From: Sagatelian, Marguerite
Sent: Friday, February 22, 2013 11:13 AM
To: Anderson, James L.
Subject: Bay Cities

I just got off a lengthy conference call with Dianne and Pat (as well as Greg and John Bowman, the review examiner) regarding [Redacted]. Dianne is concerned that we are putting a lot of resources into this case and that, unless we can show fraud or other misconduct by the payday lenders, we will not be able to hold the bank responsible. After much discussion, we agreed to: (1) complete our review of bank emails; (2) review the risk management exam report and draft consent order regarding BSA violations; and (3) find out more about the US Attorney's investigation (that office obtained copies of the bank's emails right after we did). Once that is done, we will reevaluate our game plan. We have to let Dianne know next week the timetable for completing the email review.

During the course of the discussion, I mentioned our meeting with Mark and his interest in trying to find a way to stop our banks from facilitating payday lending.

Let me know if you have any questions.

On March 8, 2013, the Senior Counsel wrote two FDIC attorneys within the Legal Division and asked about ways the FDIC could “get at payday lending.”³⁵ The email explains that Consumer Enforcement Unit received a request from Division of Consumer and Depositor Protection to look into “what avenues are available to the FDIC to take action against banks that facilitate payday lending”:

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 9:32 AM
To: [Redacted]; [Redacted]
Subject: Payday Lending

[Redacted] and [Redacted]

I've received an inquiry from DCP about where we stand regarding our research into what avenues are available to the FDIC to take action against banks that facilitate payday lending. I have the memo you did a while back. Has that memo been updated? I know that after we met with Mark, you were going to explore the BSA/Know Your Customer requirements to see if that would provide the FDIC with the means to get at payday lending (either by the bank's direct customer or through a third party payment processor).

Please let me know where things stand and send me any updated memo you have completed.

Thanks,
Marguerite

Marguerite Sagatelian
FDIC
Senior Counsel Consumer Enforcement Unit

³⁴ *Id.*

³⁵ Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, to two Counsel in Legal Division, Federal Deposit Insurance Corporation (Mar. 8, 2013 09:32), FDICHOGR00006907.

This blanket call to target an entire industry is chilling: no reference is made to either safety and soundness or consumer protection. Accordingly, such actions are entirely outside of FDIC's mandate.³⁶ The Senior Counsel goes on to explain how the information requested would be included in talking points for Chairman Gruenberg as to how banks facilitate payday lending and why the FDIC is concerned:

From: [REDACTED]
Sent: Friday, March 08, 2013 2:53 PM
To: Sagatelian, Marguerite; [REDACTED]
Subject: RE: Payday Lending

Will do.

A note that both Joel Sweet (of DOJ) and Mike Benardo emphasized: although payday lending is a particularly ugly practice, it is only one of the TPPP problems out there. And as we have noted, [REDACTED] "may" be one of them, where the non-bank part of the equation was misusing payroll taxes and apparently was quite well known in the lower echelons.

From: Sagatelian, Marguerite
Sent: Friday, March 08, 2013 10:49 AM
To: [REDACTED]; [REDACTED]
Subject: RE: Payday Lending

Thank you, both. What has prompted today's inquiry is that the Chairman is meeting with some bankers next week, and DCP wants to give the Chairman some "talking points" as to how banks facilitate payday lending and why the FDIC is concerned. I think your supplemental memo addresses that point. We have a few TPPP cases right now, two of which are with [REDACTED] and [REDACTED]. Please make sure that you coordinate your efforts with [REDACTED] and [REDACTED] so that we develop a consistent approach regarding TPPPs. Thanks.

An attorney within the Legal Division describes the very existence of payday lending as "a particularly ugly practice" in response to the Senior Counsel's email.³⁷

Personal animus towards payday lending is apparent throughout documents produced to the Committee. In one egregious example, the DCP's Deputy Director for Policy & Research insisted that Chairman Gruenberg's letters to Congress and talking points always mention *pornography* when discussing payday lending, in an effort to convey a "good picture regarding the unsavory nature of the businesses at issue."³⁸ The email, sent by a Counsel in the Legal Division, outlines a meeting that occurred with the Deputy Director:

³⁶ Federal Deposit Insurance Corporation, FDIC Mission, Vision, and Values, *available at* <https://www.fdic.gov/about/mission/>.

³⁷ Email from a Counsel, Legal Division, Federal Deposit Insurance Corporation to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Federal Deposit Insurance Corporation (Mar. 8, 2013 14:53), FDICHOGR00005178.

³⁸ Email from a Counsel, Legal Division, FDIC, to Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, FDIC (Aug. 28, 2013 9:32), FDICHOGR00007424.

From: [REDACTED]
Sent: Wednesday, August 28, 2013 9:32 AM
To: Sagatelian, Marguerite
Cc: [REDACTED]; [REDACTED]
Subject: Pornography

FYI:

I just got a call from Jonathan Miller regarding why we kept taking pornography out of their write up.

I explained that we felt there was a difference between on-line gambling and payday lending (which are illegal in some states) and pornography (which may be immoral, but which is not per se illegal). I noted that we didn't want to seem like we as a regulator were making moral judgments regarding the types of businesses with which our institutions deal. Rather, we wanted to make it clear that we were making rational safety and soundness decisions by discouraging our institutions from engaging in or facilitating illegal transactions.

Jonathan heard where we were coming from, but nonetheless wants to retain a reference to pornography in our letters / talking points. He thinks it's important for Congress to get a good picture regarding the unsavory nature of the businesses at issue. He repeated that "one is judged by the friends one keeps," and he seems to feel strongly that including payday lenders in the same circle as pornographers and on-line gambling businesses will ultimately help with the messaging on this issue.

If you feel that there is legal argument beyond the one I made, and would like us to push back on this issue, please let me know.

[REDACTED]

[REDACTED] Counsel
Federal Deposit Insurance Corporation
Legal Division, Consumer Enforcement Unit

It appears senior officials recognized the inherent impropriety of FDIC's policy. In an email to DCP Director Mark Pearce, the FDIC spokesman described the basis for congressional oversight of the issue.³⁹ The spokesman noted that "[s]ome of the pushback from the Hill is that it is not up to the FDIC decide what is moral and immoral, but rather what type of lending is legal":

³⁹ Email from David Barr, Assistant Director, Office of Public Affairs, FDIC to Mark Pearce, Director, Division of Depositor and Consumer Protection, FDIC (Sep. 13, 2013 10:38), FDICHOG00005240.

From:	Barr, David
Sent:	Friday, September 13, 2013 10:38 AM
To:	Pearce, Mark (DCP); Brueger, Kathleen S.; Spitler, Eric J.; Miller, Rae-Ann; Watkins, James C.
Cc:	Gray, Andrew; French, George; Plunkett, Sylvia H.; Eberley, Doreen R.; Miller, Jonathan N. (DCP); Brown, Luke H.
Subject:	RE: 3rd Party Payment Providers

I got a bit more background from Joe on this piece. They are looking at the on-line lending issue as a whole. Part of it will focus on regulators forcing banks out of relationships with payment processors who work with these on-line lenders. Joe has heard second and third hand information that a senior FDIC official has called on-line lending immoral, according to a banker who heard it from an examiner. Some of the pushback from The Hill is that it is not up to the FDIC decide what is moral and immoral, but rather what type of lending is legal. The GOP is saying that the FDIC doesn't like on-line lending and is forcing banks to end their relationships with payment providers. This is hurting even the good "apples" out there. They agree that some of the on-line lenders are not good, but our widespread decision to force banks out of the business is cutting off credit to those that need it, and forcing even the good lenders to exit the business. Joe has also heard that there was a recent Hill briefing on this and we have denied that we are forcing banks to end these relationships. It's the same thing we said a couple of years ago when it was the brick-and-mortar payday lenders that we denied forcing out of banking relationships. Now it's on-line lenders.

--db

The spokesman continues by stating that the FDIC has denied that they are forcing banks to end relationships with payday lenders.⁴⁰ Documents obtained by the Committee prove this statement is false. As late as March 2013, FDIC officials were “**looking into avenues by which the FDIC can potentially prevent our banks from facilitating payday lending.**”⁴¹ [emphasis added] Ultimately, senior officials at FDIC headquarters were successful in choking-out payday lenders’ access to the banking system. As of June 2014, over 80 banks have terminated business relationships with payday lenders as a result of FDIC targeting.⁴²

b. FDIC Field-level Examiners Ordered Banks to Cease Relationships With Payday Lenders

While formal policy is formulated in the agency’s Washington and Arlington headquarters, FDIC’s supervisory and examination responsibilities are executed by the Regional Offices, and the agency conducts much of its business at the regional and field-office level.⁴³ There is evidence FDIC headquarters lacks effective institutional control over its examination staff. In fact, documents produced to the Committee confirm that senior officials are aware that FDIC examiners are injecting personal value judgments into the examination process.⁴⁴ In an email to DCP Director Mark Pearce concerning agency policy with respect to payday lending, a DCP Deputy Director observes, “I may have to confront the **issue of overzealous examiners**

⁴⁰ *Id.*

⁴¹ Email from Marguerite Sagatelian, Senior Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to Surge Sen, Section Chief, Division of Consumer and Depositor Protection, Federal Deposit Insurance Corporation (Mar. 8, 2013 11:15), FDICHOGR00006052.

⁴² Victoria McGrane, *Regulators Seek Dismissal of ‘Choke Point’ Lawsuit*, WALL ST. J., Aug. 19, 2014.

⁴³ Federal Deposit Insurance Corporation, *Who is the FDIC?*, available at <https://www.fdic.gov/about/learn/symbol/>

⁴⁴ Email from Deputy Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation to the Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation (Sep. 5, 2013 18:13), FDICHOGR00005133.

(immoral issue). I would do so by making clear that it is not fdic [sic] policy to pass moral judgment on specific products.”⁴⁵ [emphasis added]

Documents produced to the Committee justify these concerns: internal emails reveal that FDIC examiners were actively engaging in measures to prohibit or discourage relationships with payday lenders. In response to request for guidance on payday lending from the president of an unnamed bank, an FDIC Field Supervisor in the Atlanta Region wrote, “Even under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer.”⁴⁶

As I stated earlier, the arrangement will receive close regulatory scrutiny from the FDIC and State Banking Department. In-depth BSA and IT reviews of this relationship will also take place. Even under the best circumstances, if this venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer.

If the Board plans to go forward with this venture, please reduce your plans to writing by submitting a letter to the FDIC’s Regional Director (Thomas J. Dujenski) and the Superintendent of Banks for the State of Alabama (John Harrison) outlining your proposal.

This communication is particularly troubling, as the Field Supervisor candidly acknowledges that *no amount* of monitoring, controls, and risk-mitigation will be sufficient for FDIC.⁴⁷

In a far more glaring abuse of the examination process, a senior FDIC official effectively ordered a bank to terminate all relationships with payday lenders. On February 15, 2013, the Director of the Chicago Region wrote to a bank’s Board of Directors and informed them the FDIC has found “that activities related to payday lending are unacceptable for an insured depository institution.”⁴⁸

The focus of our visitation was on the risk associated with this relationship, compliance with consumer protection laws and regulations, and the effectiveness of Board and senior management due diligence and oversight of this relationship and the corresponding payday lending-related activities. It is our view that payday loans are costly, and offer limited utility for consumers, as compared to traditional loan products. Furthermore, the [Redacted] relationship carries a high degree of risk to the institution, including third-party, reputational, compliance, and legal risk, which may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution.

⁴⁵ *Id.*

⁴⁶ Email from Field Supervisor, Atlanta Region, Federal Deposit Insurance Corporation to unnamed bank (Mar. 6, 2014 09:43) (bank name redacted by FDIC), FDICHOGR00004249.

⁴⁷ *Id.*

⁴⁸ Letter from M. Anthony Lowe, Regional Director, Chicago Regional Office, FDIC to Members of the Board of Directors, unnamed bank (Feb. 15, 2013) (bank name redacted by FDIC), FDICICR0085.

Mr. Lowe is the Director of one of FDIC's six regional offices. His statements – particularly those in official communications to supervised institutions, under his signature – are understood by banks within the region to be FDIC's formal supervisory policy.

There is evidence examiners' campaign against payday lending even extended to threats. At a hearing before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law of the House Judiciary Committee, Chairman Bob Goodlatte revealed that senior FDIC regulators went as far as threatening a banker with an immediate audit unless the bank severed all relationships with payday lenders. Chairman Goodlatte explained in his opening statement:

For example, the committee obtained a jarring account of a meeting between a senior FDIC regulator and a banker contemplating serving a payday lending client. The official told the banker, "I don't like this product, and I don't believe it has any place in our financial system. Your decision to move forward will result in an immediate unplanned audit of your entire bank."⁴⁹

Communications between the senior-most officials at FDIC provide critical context for the agency's documented actions with respect to payday lending. One email from Atlanta Regional Director Thomas Dujenski to DCP Director Mark Pearce, with the subject line "Confidential," is revealing.⁵⁰

-----Original Message-----

From: Dujenski, Thomas J.
Sent: Monday, November 26, 2012 4:47 PM
To: Pearce, Mark (DCP)
Subject: Confidential

I have never said this to you (but I am sincerely passionate about this)...but I literally can not stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking. I had extensive involvement with this group of lenders and was instrumental in drafting guidance on stopping abuses.

I really hope this bank we discussed truly gets out of this on their own as they are indicating.....I hope my persuasion skills are still effective :). I feel strongly we will do good things here!!!!

Sent from my BlackBerry Wireless Handheld

⁴⁹ *Guilty Until Proven Innocent? A Study of the Propriety & Legal Authority for the Justice Department's Operation Choke Point: Hearing before the H. Comm. On the Judiciary, 113th Cong. (Jul. 17, 2014)* (Oversight Committee staff have learned from a whistleblower that the remarks are attributed to Jim LaPierre, Regional Director of the Kansas City Region).

⁵⁰ E-mail from Thomas J. Dujenski, Regional Director, Atlanta Region, Federal Deposit Insurance Corporation, to Mark Pearce, Director, Division of Consumer Protection, Federal Deposit Insurance Corporation (Nov. 27, 2012, 20:40:05), FDICHOGR00006585.

Director Pearce responded with apparent agreement:

To: Dujenski, Thomas J.[TDujenski@FDIC.gov]
From: Pearce, Mark (DCP)
Sent: Tue 11/27/2012 8:40:05 PM
Subject: RE: Confidential

I remember!!

Thanks for the briefing today.

Mark Pearce
Director, Division of Depositor and Consumer Protection
Federal Deposit Insurance Corporation
(202) 898-7088

Notwithstanding the emotional intensity of their beliefs, it is entirely unacceptable for senior FDIC officials to inject personal moral judgments into the bank examination process. Writing in *USA Today*, Glenn Reynolds expressed concern with the unforeseen consequences of allowing the federal regulators to pressure banks to shut down the accounts of legal industries: “while abortion clinics and environmental groups are probably safe under the Obama Administration, if this sort of thing stands, they will be vulnerable to the same tactics if a different administration adopts this same thuggish approach toward the businesses that it dislikes.”⁵¹ It is entirely possible to conceive of an equally zealous Regional Director writing an email similar to Mr. Dujenski’s, yet replacing “pay day lending” with “abortion providers.”

IV. **FDIC Actively Partnered With the Department of Justice to Implement “Operation Choke Point”**

A primary concern for the Committee is FDIC’s cooperation with the Department of Justice on Operation Choke Point. As described in the staff report of May 29, 2014, the Committee has serious concerns with the Department’s motivations, legal theories, and investigative approach.⁵² In their June 9, 2014 letter to FDIC Chairman Gruenberg, Chairman Issa and Subcommittee Chairman Jordan cited internal DOJ memoranda describing FDIC’s participation in the initiative. For example, DOJ’s initial proposal for Operation Choke Point described FDIC as a “partner agency” in the initiative.⁵³ A later memorandum describes how FDIC even went as far as to volunteer two of its attorneys for the program.⁵⁴

Documents produced to the Committee by FDIC reveal the intensity of their collaboration with DOJ. Through March, April, and May 2013, senior officials within FDIC and

⁵¹ Glenn Harlan Reynolds, *Justice Department shuts down porn money: Column*, USA TODAY, May 26, 2014.

⁵² STAFF OF THE H. COMM. ON OVERSIGHT AND GOV’T REFORM, 113TH CONG., REPORT ON THE DEPARTMENT OF JUSTICE’S “OPERATION CHOKE POINT”: ILLEGALLY CHOKING OFF LEGITIMATE BUSINESSES? (May 29, 2014).

⁵³ Memorandum from an Assistant United States Attorney, Eastern District of Pennsylvania, to the Acting Assistant Attorney General for the Civil Division, U.S. Dep’t of Justice (Nov. 5, 2013), HOCR-3PPP00019.

⁵⁴ Memorandum from the Director of Consumer Protection Branch to the Acting Assistant Attorney General for the Civil Division, U.S. Dep’t of Justice (July 8, 2013), HOCR3PPP000167.

DOJ held numerous meetings on how to combine efforts.⁵⁵ Officials such as Michael Bresnick, Executive Director of the President’s Financial Fraud Enforcement Task Force and Joel Sweet, the DOJ Trial Attorney who initially proposed Operation Choke Point, frequently consulted with FDIC attorneys and senior officials. An FDIC Counsel within the Legal Division even went as far as to suggest a detail to DOJ as a Special Assistant United States Attorney.⁵⁶ A fundamental purpose of this collaboration was to jointly formulate legal investigative theories.⁵⁷

The FDIC Legal Division’s operational practices further reflect joint ownership of the program. In summer 2013, an FDIC attorney instructed staff to create a “matter” – an official file within FDIC’s Advanced Legal Information System – specifically named “Operation Chokepoint.”⁵⁸ This file allowed FDIC attorneys to review documents received in response to DOJ’s subpoenas. Furthermore, DOJ began allowing two FDIC attorneys direct access to a confidential Justice Department system database named “Operation Choke Point.”⁵⁹ Over the next several months, FDIC attorneys utilized this database to directly participate in the program.

The agencies’ collaboration was so intense, in fact, that DOJ attached FDIC’s list of “high-risk” merchants to the back of the subpoenas served upon banks and payment processors.⁶⁰ During a hearing before the Subcommittee on Regulatory Reform, Commercial and Antitrust law of the House Judiciary Committee, Representative Issa entered into the record one such subpoena provided by a whistleblower. The subpoena was identical to many of those that were served on over fifty financial institutions. In response to questions from Members of the Subcommittee, Assistant Attorney General Stuart Delery confirmed that DOJ stapled the FDIC guidance to the subpoenas issued under his signature.⁶¹

⁵⁵ E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep’t of Justice (Mar. 11, 2013 13:50), FDICHOGR00000724; E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep’t of Justice (Apr. 23, 2013 12:15), FDICHOGR00000974; E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, FDIC to Joel Sweet, Trial Attorney, Consumer Protection Branch, DOJ (May 20, 2013 10:26), FDICHOGR00001021.

⁵⁶ E-mail from a Counsel, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep’t of Justice (Apr. 29, 2013 13:12), FDICHOGR00000071; E-mail from Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep’t of Justice to Counsels, Legal Division, Consumer Enforcement Unit, Federal Deposit Insurance Corporation, and Michael Bresnick, Executive Director, Financial Fraud Enforcement Task Force (May 20, 2013 16:23), FDICHOGR00001029.

⁵⁷ E-mail from a Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to Joel Sweet, Trial Attorney, Consumer Protection Branch, U.S. Dep’t of Justice (Apr. 26, 2013 08:47), FDICHOGR00000980.

⁵⁸ E-mail from a Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to staff within the Legal Division, Federal Deposit Insurance Corporation, (Jun. 27, 2013, 16:58), FDICHOGR00003533.

⁵⁹ E-mail from a Counsel, Consumer Enforcement Unit, Legal Division, Federal Deposit Insurance Corporation to official in Charles Dunn, Civil Division, U.S. Dep’t of Justice (Jul. 31, 2013 16:51), FDICHOGR00001062.

⁶⁰ Memorandum from the Director of Consumer Protection Branch, Civil Division, U.S. Dep’t of Justice, to the Acting Assistant Attorney General, Civil Division, U.S. Dep’t of Justice (July 8, 2013), HOGR3PPP000167.

⁶¹ *Guilty Until Proven Innocent? A Study of the Propriety & Legal Authority for the Justice Department’s Operation Choke Point: Hearing before the H. Comm. On the Judiciary*, 113th Cong. (Jul. 17, 2014).

The inclusion of the FDIC guidance in DOJ's subpoenas effectively "weaponized" the high-risk merchants list. The implication was clear: banks were compelled to remove those clients from their portfolios, or risk a federal investigation by the Department of Justice. Tellingly, one FDIC counsel even described Operation Choke Point as "our DOJ/Spike Lee Joint."⁶² Although meant facetiously, such phrasing inherently reflects the agencies' joint sense of ownership of the program.

V. FDIC Response to Congressional Oversight

Congressional oversight of FDIC's involvement in Operation Choke Point began in August 2013. Following an initial report on the program in the *Wall Street Journal*, Representative Blaine Luetkemeyer and thirty Members of Congress wrote to FDIC Chairman Gruenberg, expressing serious concern with FDIC's supervisory policies.⁶³ In a September 17, 2013 response, Chairman Gruenberg reaffirmed the list of "high-risk" merchants, and asserted that FDIC's focus is "the proper management of the banks' relationships with their customers, particularly those engaged in higher risk activities, and not underlying activities that are permissible under state and federal law."⁶⁴

On April 7, 2014, FDIC's Acting General Counsel, Richard J. Osterman, testified at a House Financial Services Committee hearing on federal financial regulatory policy. Over the course of the hearing, Mr. Osterman repeatedly disclaimed any substantive involvement by the FDIC with Operation Choke Point. However, as evidenced in Chairman Issa and Subcommittee Chairman Jordan's letter to FDIC Chairman Gruenberg on June 9, 2014, internal DOJ documents produced to the Committee directly contradict Mr. Osterman's testimony.⁶⁵ Internal FDIC documents produced to the Committee provide further evidence of close collaboration between the two agencies and joint ownership of the initiative.⁶⁶

On July 15, 2014, Mr. Osterman testified at a hearing before the Subcommittee on Oversight and Investigations of the House Financial Services Committee.⁶⁷ In light of the evidence presented in Chairman Issa and Subcommittee Chairman Jordan's letter of June 9th, Mr. Osterman revised his earlier testimony to the Financial Services Committee.⁶⁸ His written statement candidly concedes that FDIC staff closely cooperated in the prosecution of Operation Choke Point:

⁶² E-mail from Counsel, Consumer Enforcement Unit, Legal Division, to staff within the Legal Division, Consumer Section (Jul. 23, 2013, 16:02), FDICHOGR00003557.

⁶³ Letter from Rep. Blaine Luetkemeyer, et al., to Eric H. Holder, Jr., Att'y Gen., U.S. Dep't of Justice, and Martin J. Gruenberg, Chairman, Federal Deposit Insurance Commission, Aug. 22, 2013.

⁶⁴ Letter from Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, to Rep. Blaine Luetkemeyer, Sept. 17, 2013.

⁶⁵ Letter from Darrell Issa, Chairman, H. Comm. on Oversight and Gov't Reform, and Jim Jordan, Chairman, Subcomm. on Economic Growth, Job Creation and Regulatory Affairs of the H. Comm. on Oversight and Gov't Reform, to Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, June 9, 2014.

⁶⁶ See *supra* Section IV.

⁶⁷ *The Department of Justice's "Operation Choke Point": Hearing before Subcomm. on Oversight and Investigations of the H. Comm. On Fin. Services*, 113th Cong. (July 15, 2013).

⁶⁸ *Id.* (written statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation).

Accordingly, FDIC staff communicated and cooperated with DOJ staff involved in Operation Choke Point based on an interest in DOJ's investigation into potential illegal activity that may involve FDIC-supervised institutions. FDIC attorneys' communication and cooperation with DOJ included requests for information about the investigation, discussions of legal theories and the application of banking laws, and the review of documents involving FDIC-supervised institutions obtained by DOJ in the course of its investigation.⁶⁹

Unfortunately, there remain serious questions as to the truthfulness of Mr. Osterman's July 15th testimony. Specifically, Mr. Osterman repeatedly denied that FDIC singles out any particular merchant or business line for inappropriate scrutiny. At the conclusion of his opening statement, Mr. Osterman noted:

[O]ur supervisory approach focuses on assessing whether financial institutions are adequately overseeing activities and transactions they process, and appropriately managing and mitigating risks. We're not focused on particular businesses.

Each bank must decide the persons and entities with which it wants to have a customer or business relationship. Financial institutions that properly manage customer relationships, and effectively mitigate risks, are neither prohibited, nor discouraged, from providing payment-processor services to customers, regardless of the customers' business models, provided they're operating in compliance with applicable laws.⁷⁰

Mr. Osterman maintained this assertion while replying to questions from Members of the Financial Services Committee. In response to a question from Representative Luetkemeyer, Mr. Osterman stated:

Congressman Luetkemeyer, what we've done is we've tried to be very clear in putting out our guidance to say very publicly and clearly that as long as banks have appropriate risk-mitigation measures in place, we're not going to prohibit or discourage them from doing business with anyone who they want to do business with.⁷¹

As noted in Section III of this report, documents produced to Committee unequivocally demonstrate that FDIC officials did attempt to "prohibit or discourage" banks from serving particular merchants and business lines.⁷² Furthermore, these efforts were prosecuted by both field-level examiners and policymakers in FDIC headquarters, including Mr. Osterman's own subordinates in the Legal Division.⁷³ It is possible FDIC may have intended to convey that it did not *currently* target specific industries, even if that had been its past policy. The Committee is

⁶⁹ *Id.*

⁷⁰ *Id.* (opening statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation).

⁷¹ *Id.* (statement of Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation in response to a question from Rep. Blaine Luetkemeyer).

⁷² See *supra* Section III.

⁷³ *Id.*

hopeful that Mr. Osterman did not intentionally and evasively couch his language in the present tense, in a grammatical end-run around his personal and legal obligation to be fully candid in congressional testimony.⁷⁴

Notwithstanding these concerns, the Committee recognizes FDIC's cooperation with Chairman Issa and Subcommittee Chairman Jordan's document request. Furthermore, FDIC does appear to be taking incremental steps to end the indiscriminate termination of whole industries by FDIC-supervised banks. On July 28, 2014, FDIC issued Financial Institution Letter 41-2014, "Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors."⁷⁵ This FIL candidly acknowledges that lists of high-risk merchant categories "have led to misunderstandings regarding FDIC's supervisory approach to TPPPs, creating the misperception that the listed examples of merchant categories were prohibited or discouraged."⁷⁶ Accordingly, FDIC officially retracted the summer 2011 *Supervisory Insights* article and FIL-3-2012, and reissued them without the offending lists.⁷⁷ While this is a positive and important step, the implementation of this policy remains a critical concern for future congressional oversight. As FDIC has candidly acknowledged, agency policy is only effective to the degree it is reiterated to the Regional Offices and faithfully executed by field examiners.⁷⁸

VI. Conclusion

The practical impact of Operation Choke Point is incontrovertible: legal and legitimate businesses are being choked off from the financial system. Confidential briefing documents produced to the Committee reveal that senior DOJ officials informed the Attorney General himself that, as a consequence of Operation Choke Point, banks are "exiting" lines of business deemed "high-risk" by federal regulators.⁷⁹

The experience of firearms and ammunitions dealers – one of the most heavily regulated businesses in the United States – is a testament to the destructive and unacceptable impact of Operation Choke Point. TomKat Ammunition, a small business selling ammunition in the state of Maryland, holds a Type 06 Federal Firearms License from the Bureau of Alcohol, Tobacco, Firearms and Explosives, two Maryland State Licenses for Manufacturing and Dealing in Explosives, and a local business license.⁸⁰ Notwithstanding the extraordinary complexity of this regulatory regime, over the past year TomKat Ammunition has been systemically denied access to the financial system. One bank refused to provide payment processing services due to their

⁷⁴ 18 U.S.C § 1001.

⁷⁵ Federal Deposit Insurance Corporation, Financial Institution Letter, FIL-41-2014, July 28, 2014.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *See, e.g.,* Letter from Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, to Rep. Blaine Luetkemeyer, Sept. 17, 2013 (" . . . we have reiterated to our Regional Directors, who will in turn communicate to our field examiners, that communications with banks in relationships with merchants engaged in higher-risk activities must be consistent with FDIC policy.").

⁷⁹ E-mail from the Chief of Staff, Civil Division, U.S. Dep't of Justice, to the Assistant Attorney General, Civil Division, U.S. Dep't of Justice (Nov. 18, 2013, 20:51) (containing briefing points on Operation Choke Point for the Attorney General), HOCR-3PPP000458.

⁸⁰ Letter from Kat O'Connor, TomKat Ammunition, LLC, to U.S. Consumer Coalition, *available at* <http://usconsumers.org/wp-content/uploads/2014/10/TomKat-letter.pdf>.

“industry.” A large online payment processor informed TomKat that they “could not offer that service due to [their] line of work.” Another credit card processor stated it would no longer allow businesses to process gun or ammunition purchases.

Media accounts record similar experiences. In South Carolina, Inman Gun and Pawn’s longstanding checking accounts were terminated after the company was deemed a “prohibited business type.”⁸¹ In Wisconsin, Hawkins Guns LLC opened an account at a local credit union. The credit union terminated the account the very next day, informing the company that “they do not service companies that deal in guns.”⁸² In all three of these cases, the financial institutions and payment processors made no reference to the merchants’ creditworthiness, individual risk profile, or due diligence findings. The sole basis for the terminations is their participation in an industry deemed “high risk” by federal regulators.

Recognizing the irreparable harm to legal and legitimate industries, even fellow regulators have taken the extraordinary step of criticizing the impacts of Operation Choke Point. In a major speech at a joint conference of the American Bar Association and the American Bankers Association on November 10, 2014, David Cohen, the Under Secretary for Terrorism and Financial Intelligence at the Treasury Department, warned of the dangers of “de-risking.”⁸³ Mr. Cohen explained that de-risking occurs when a financial institution terminates or restricts business relationships simply to avoid perceived regulatory risk, rather than in response to an assessment of the actual risk of illicit activity.⁸⁴ The Under Secretary went as far as to characterize de-risking as “the antithesis of an appropriate risk-based approach,” warning that the practice can “undermine financial inclusion, financial transparency and financial activity, with associated political, regulatory, economic and social consequences.”⁸⁵

At a minimum, Operation Choke Point is little more than government-mandated de-risking. FDIC, in cooperation with the Justice Department, made sure banks understood – or in their own language, “got the message” – that maintaining relationships with certain disfavored business lines would incur enormous regulatory risk.⁸⁶ The effect of this policy has been to deny countless legal and legitimate merchants access to the financial system and deprive them of their very ability to exist. Accordingly, Operation Choke Point violates the most fundamental principles of the rule of law and accountable, transparent government.

⁸¹ Jennifer Phillips, *Gun, pawn shop owner says bank targeted business*, FOX CAROLINA, Aug. 6, 2014.

⁸² Donovan Slack, *Duffy to target financial regulators in new post*, THE POST-CRESCENT, Nov. 21, 2014.

⁸³ David S. Cohen, Under Secretary for Terrorism and Financial Intelligence, U.S. Dep’t of the Treasury, Remarks at the ABA/ABA Money Laundering Enforcement Conference: Effectively Combating Money Laundering and Terrorist Financing (Nov. 10, 2014).

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *See supra* note 22.