# THE FEDERAL DEPOSIT INSURANCE CORPORATION'S ROLE IN OPERATION CHOKE POINT

## HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

MARCH 24, 2015

Printed for the use of the Committee on Financial Services

**Serial No. 114–11**

U.S. GOVERNMENT PUBLISHING OFFICE

95–055 PDF WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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# THE FEDERAL DEPOSIT INSURANCE CORPORATION'S ROLE IN OPERATION CHOKE POINT

**Tuesday, March 24, 2015**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:33 p.m., in room HVC–210, Capitol Visitor Center, Hon. Sean P. Duffy [chairman of the subcommittee] presiding.

Members present: Representatives Duffy, Fitzpatrick, Fincher, Mulvaney, Tipton, Poliquin, Hill; Green, Cleaver, Ellison, Delaney, Beatty, Heck, Sinema, and Vargas.

Ex officio present: Representative Hensarling.

Chairman DUFFY. The Oversight and Investigations Subcommittee will come to order.

The title of today's subcommittee hearing is, "The Federal Deposit Insurance Corporation's Role in Operation Choke Point."

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee may participate in today's hearing for the purpose of making an opening statement and questioning the witness, FDIC Chairman Martin Gruenberg.

The Chair now recognizes himself for 3 minutes for an opening statement.

Thank you for being here, Chairman Gruenberg. I want to thank you for your willingness and commitment to working with this subcommittee. Both you and your staff have been very responsive to our requests, releasing documents to us and making your staff available for questioning throughout the past week.

I was, however, very surprised and troubled to learn that the White House doesn't share the same confidence in our mutual cooperation. As you know, we asked three members of your staff to voluntarily meet with both Majority and Minority committee staff for interviews and they all complied voluntarily.

Before one of the interviews, however, I understand there was a telephone conversation between the White House and the FDIC General Counsel in which concerns were raised over the former Acting General Counsel's voluntary participation in the oversight

process. To his credit, the FDIC former Acting General Counsel, nonetheless, appeared as scheduled and met with committee staff. Kudos to him.

I hope that this afternoon you will not be deterred by the White House's interference, instead continuing to be forthcoming when answering our questions about how your agency is working to repair the business relationships that have been destroyed and damaged since the FDIC's so-called high-risk list was released several years ago.

As many Members know, this is the subcommittee's second hearing on the topic of Operation Choke Point, and the second hearing where representatives from the FDIC have appeared to discuss their role in it.

Since then, most of the staff that we have spoken to at the FDIC, including you, Chairman Gruenberg, have contended that you have not participated with the DOJ in Operation Choke Point, nor is the FDIC taking part in any way in Operation Choke Point. I imagine that will also be in your testimony today.

But Members have heard from too many of our constituents that even if the FDIC isn't calling it Operation Choke Point, examiners within the FDIC are making morally-based directives on what is legal and law-abiding for businesses as they find banking partners.

Using the term "reputational risk," they are warning banks that if they do business with gun dealers, short-term lenders, payday lenders, ammunition manufacturers, smoke shops, and other legal businesses, they will meet the wrath of the FDIC. And if you disagree, Mr. Chairman, we have emails and memos from the FDIC to prove it. Their purpose is to choke off the business they don't like from the banking system.

I asked you to testify today, Chairman Gruenberg, because I want to know where you got the target list from several years ago. And, like the IRS, I fear that activists at the DOJ and the FDIC are abusing their power and authority and are going after legal businesses and, in effect, they are weaponizing government to meet their ideological beliefs. I hope that today, Chairman Gruenberg, you can convince us that is not the case.

With that, I now yield to the ranking member of the subcommittee, Mr. Green from North Carolina, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And, if I may, I will be from Texas today.

Mr. Chairman, if I may just take a moment of my time to congratulate Jason, who is a part of our team. As you know, our staff does excellent work. And Jason, who is a part of our team, is not here today. He is on his way to celebrate his marriage. And I am honored to say that we will miss him, but we are proud that he is now taking on a beautiful bride.

Mr. Chairman, I want to thank you, and thank the witness for appearing as well. Mr. Chairman, for those who are watching today and unfamiliar with the term "Operation Choke Point," it is generally viewed as a Department of Justice initiative aimed at protecting consumers by scrutinizing certain financial institutions and their role in providing access points to the banking system for industries and businesses with higher risk of fraud. And that is what

we will be talking about today, Operation Choke Point, for the most part.

Fraudulent transactions in our banking system are a real issue, not to be taken lightly. In 2012, the Federal Reserve estimated that there were 31.1 million unauthorized transactions, worth $6.1 billion, through third-party payment processors, which are businesses that, for a fee, take payments from consumers and deposit them in banks for merchants.

In addition, a 2012 Economist article suggests that in the United States, 42 percent of Americans have experienced some form of payment card fraud in the preceding 5 years. Given that the FDIC is a prudential regulator of many financial institutions that take on consumer deposits, it should come as little surprise that they, too, are interested in addressing fraud in our banking system.

However, we should not confuse the FDIC doing its job as a regulator as evidence that it is doing anything more than fulfilling its mission. Some have gone to great lengths to rely on email exchanges and supervisory guidance to connect the FDIC to this DOJ effort, Operation Choke Point. Reports have been published and accusations leveled.

However, the truth remains that the FDIC had been monitoring and regulating fraud at the financial institutions it oversees long before there was ever a formal Operation Choke Point.

Some may draw attention to a supervisory letter issued by the FDIC in 2011 highlighting a list of high-risk industries as evidence of their involvement in Choke Point by means of prohibiting banks from doing business with entities on this list.

In truth, this was an attempt by the FDIC to help financial institutions be aware of the higher rates of fraud sometimes associated with certain industries. The list was compiled based on input from the third-party payment processors who do business with the industries.

Nonetheless, when notified of concern by banks that their list was potentially being misconstrued and misapplied during examinations, the FDIC took definitive action to clarify that banks could continue doing business, continue their business relationships with any industry, as long as proper due diligence was executed to protect consumers. And that is really what this is about, protecting consumers.

Furthermore, in the interest of eliminating confusion, the FDIC retracted the list. These actions do not equate to a Federal regulator overstepping its bounds to put businesses out of business. In fact, it illustrates a government agency willing to listen to the concerns of the entities it regulates and adjust its actions accordingly.

I would, however, like to take a moment to recognize a more serious issue regarding the off-the-cuff comments made by employees at the FDIC as it relates to the banking relations of certain industries. While I do not think excessive credence should be given to remarks made off-the-cuff, I do expect FDIC examiners to act responsibly.

I understand that an internal Inspector General (IG) investigation is under way to determine whether any misconduct has occurred. Based on the actions already taken by the FDIC to be re-

sponsive to the concerns raised, I fully expect the FDIC to address these findings, if any, made by the IG.

I will close by expressing my gratitude to the chairman for his leadership. And I hope that this hearing will clarify the FDIC's longstanding mandate to combat fraud and protect depositors.

Thank you, Mr. Chairman.

Chairman DUFFY. Thank you.

The Chair now recognizes the vice chairman of the subcommittee, the gentleman from Pennsylvania, Mr. Fitzpatrick, for 1 minute.

Mr. FITZPATRICK. Thank you, Chairman Duffy. And thank you for staying focused on this very important issue.

We are here today because individuals within the Federal Government decided to create a policy that deliberately targeted specific businesses that, in their mind, had questionable business practices or were hurting consumers.

While we can all agree that consumer protection is a noble and worthy task, the personal preferences of unelected bureaucrats should not, and must not, be the policy of the United States. If a company or an individual is breaking the law, they should be held accountable.

However, extrajudicial punishment meted out arbitrarily runs counter to the American rule of law and, frankly, the United States Constitution. These types of actions harm the economic security of our Nation and destroy the trust that is critical between private enterprise and the Federal Government.

It is my hope, Mr. Chairman, that we can come together to understand what the FDIC's involvement was in these practices and create a bipartisan solution to ensure that this never happens again.

Chairman DUFFY. The Chair now recognizes the vice chairman of our Monetary Policy and Trade Subcommittee, the gentleman from South Carolina, Mr. Mulvaney, for an opening statement of 1 minute.

Mr. MULVANEY. Thank you, Mr. Chairman.

Chairman Gruenberg, thank you for being here today.

I will make this very brief. I have been working on this for about 2 years along with the gentleman from Missouri, Mr. Luetkemeyer. We were stunned to learn about it in the very first instance I heard about it, and we have worked diligently to try and stop this program.

And while we had heard that the program had stopped, I have had information come to me as recently as last week that not only is Choke Point not stopped, not only is it just continuing, but it is expanding. It is broader now than it was when Mr. Luetkemeyer and I started. I will talk to you specifically about that during my time.

But I will assure you that there are a lot of folks up here on this dais and folks who are not here today for whom this is the biggest thing back home. This is it. You are talking about Choke Point putting people in my district out of business: pawnshops; payday lenders; gun dealers.

I am from South Carolina, where that is a big part of what we do, and it is a big deal for us. And so, if you perceive a certain pas-

sion today in the questions, I hope you understand that this is not something intellectually removed from reality. It is not something that is theoretical. It is not something that is political. This is real. People in my district don't have jobs today because of Choke Point. And I look forward to talking to you more about that.

Chairman DUFFY. The gentleman yields back.

We now welcome our witness, the Chairman of the Federal Deposit Insurance Corporation, Chairman Gruenberg. Mr. Gruenberg was sworn in as the 20th Chairman of the FDIC on November 15, 2012, for a 5-year term.

Since August 2005, Mr. Gruenberg has served as Vice Chairman and Member of the FDIC Board of Directors. Additionally, he served as Acting Chairman twice, once from November 2005 to June 2006, and again from July 2011 to November 2012.

Mr. Gruenberg holds a law degree from Case Western Reserve Law School and an A.B. degree from Princeton University's Woodrow Wilson School of Public and International Affairs.

The witness will now be recognized for 5 minutes to give an oral presentation of his testimony. And, without objection, the witness' written statement will be made a part of the record.

Once the witness has finished presenting his testimony, each member of the subcommittee will have 5 minutes within which to ask their questions. And without objection and by previous agreement with the ranking member, the ranking member and I will each have 15 minutes of questioning at the end of the first round, as per agreement of the parties.

I want to remind the witness that while you will not be placed under oath today, your testimony is subject to 18 USC Section 1001, which makes it a crime to knowingly give false statements in proceedings such as this one. You are specifically advised that knowingly providing a false statement to this subcommittee or knowingly concealing material information from this subcommittee is a crime.

On your table there are three lights: green means go; yellow means you are running out of time; and red means stop. The microphone is sensitive, Chairman Gruenberg, so please make sure you are speaking directly into it.

And, with that, Mr. Chairman, you are recognized for 5 minutes for your opening statement.

## STATEMENT OF THE HONORABLE MARTIN J. GRUENBERG, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. GRUENBERG. Thank you, Mr. Chairman.

Chairman Duffy, Ranking Member Green, and members of the subcommittee, I appreciate the opportunity today to testify about the FDIC's role with the Department of Justice's Operation Choke Point.

One of the biggest changes in banking over the past decade has been the rapid growth of electronic commerce. With the growth in electronic transactions, there has been a corresponding growth in online illegal activity and consumer fraud. Much of this online activity requires access to the banking system often through third-

party payment processors, which has been the focus of supervisory attention.

While the vast majority of electronic transactions are legal, identifying the illegal transactions hidden among the billions of annual transactions is a major challenge for banks and regulators. Banks that help facilitate or ignore warning signs of illegal activity can find themselves held liable for this conduct which, in extreme cases, can even threaten the health of the bank.

As a bank regulator, the FDIC has a responsibility to inform the banks under our supervision about developing risks in the financial system. It also is our responsibility to ensure that banks have policies and procedures in place to identify and monitor these risks and take reasonable measures to manage and address them.

As we have stated, the FDIC's policy is that financial institutions that properly manage relationships and effectively mitigate risks are neither prohibited nor discouraged from providing services to customers, regardless of the customer's business, provided the customers are operating in compliance with applicable State and Federal law.

The FDIC's interaction with the Justice Department's Operation Choke Point grew out of the interest in ensuring the banks under our supervision are not facilitating illegal activity, especially online.

I first learned about the FDIC's interactions with the Justice Department on Operation Choke Point in August of 2013, when I received a letter from Members of Congress expressing concerns that the Justice Department and the FDIC were pressuring banks and third-party payment processors to terminate business relationships with lawful businesses.

Upon inquiring, FDIC staff informed me that in early 2013, staff at the FDIC became aware that the Justice Department was conducting an investigation into the use of banks and third-party payment processors to facilitate illegal and fraudulent activities. It was understood by the FDIC that the Justice Department's efforts were aimed at addressing illegal activity being processed through banks.

The FDIC frequently coordinates with other agencies, both Federal and State, in its supervision of its regulated institutions. Staff informed me that FDIC attorneys communicated and cooperated with Justice Department staff involved in these investigations based on an interest in any illegal activity that may involve FDIC-supervised institutions.

Nonetheless, based on the expressed concerns, it became clear that there was a need to clarify and strengthen the FDIC's supervisory approach and processes. In an attempt to address these concerns, we have taken five significant actions.

First, the FDIC issued a public statement clarifying our policy and supervisory approach. This was intended to ensure that examiners and financial institutions understand that banks with properly managed customer relationships will not be criticized for providing services to customers operating in compliance with applicable Federal and State law.

Second, the FDIC removed the list of examples from our outstanding guidance that was intended to provide greater clarity to the banking industry on how to safely conduct certain customer re-

lationships. That these examples came to be viewed as a prohibition on serving certain customers was clearly, in hindsight, a failure on our part.

Third, the FDIC issued a memorandum to all FDIC supervision staff establishing new documentation and reporting procedures where the FDIC directs the financial institution to discontinue deposit account relationships.

Any such direction by an examiner must be in writing, must identify the legal and regulatory basis for the action, must be approved by the relevant Regional Director before taking effect, and must be reported quarterly to the FDIC Board.

In addition, I met with our six Regional Directors and took part in a nationwide all-hands call with FDIC examiners to make clear our policy and the importance of following the procedures.

Fourth, the FDIC published a toll-free number and email address for both the FDIC ombudsman and the Inspector General to encourage institutions concerned that FDIC supervisory staff are not following FDIC policies on providing banking services to make confidential reports to the ombudsman or IG.

And finally, the FDIC also issued a public statement on derisking, encouraging banks to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers without regard to the risks presented by an individual customer or the financial institution's ability to manage the risk.

Looking forward, as was noted, the FDIC's Inspector General is examining allegations concerning the FDIC's role in Operation Choke Point and allegations that have been made in regard to FDIC employees. We are cooperating fully with the IG. When we receive the report, we will review the findings carefully and take appropriate action to address issues identified with either our procedures or our employees.

That concludes my statement, Mr. Chairman. I will be glad to respond to any questions.

[The prepared statement of Chairman Gruenberg can be found on page 40 of the appendix.]

Chairman DUFFY. Thank you, Chairman Gruenberg.

The Chair now recognizes the vice chairman of the subcommittee, Mr. Fitzpatrick, for 5 minutes.

Mr. FITZPATRICK. I thank the chairman.

Mr. Gruenberg, community banks in my district have felt the direct and harmful effects of Operation Choke Point and so have several private employers. The result is more red tape, costly legal fees, and less capital for lending.

And frankly, just like in Mr. Mulvaney's district, employees in my district have lost their jobs as a result of an operation that I believe neither the Department of Justice nor the FDIC wanted to be public at all.

We have all seen the emails and communications that, at the very least, suggest that bank examiners' personal opinions of particular industries have colored their views on what is considered high risk.

Recently your office issued guidance, though, stating that banks should look at individual businesses rather than entire industries. Is that true?

Mr. GRUENBERG. Yes, Congressman.

Mr. FITZPATRICK. What procedures have you put in place internally to ensure that examiners are not pressuring regulated banks to deny accounts and access to industries of which they personally disapprove?

Mr. GRUENBERG. Congressman, as I just outlined, we have established written procedures to be followed in implementing the policy. Any time an examiner believes that a bank should discontinue a relationship with a customer, that recommendation has to be put in writing.

The writing has to explain both the legal and regulatory basis for the action. The recommendation then has to be reviewed by the Regional Director before it can take effect. And any actions that actually may be implemented have to be reported on a quarterly basis to the—

Mr. FITZPATRICK. Is there a mechanism for banks that believe that they have been impacted to file some sort of a complaint with the FDIC?

Mr. GRUENBERG. Yes. As I also indicated, as part of the announcement that you referenced, in the statement we provided a phone number and email address for both our ombudsman and the FDIC Inspector General.

Mr. FITZPATRICK. What are the sanctions for examiners that violate? If a complaint is justified, what are the sanctions?

Mr. GRUENBERG. It would depend on the action of the examiner, and it would be subject to review by the agency and, ultimately, if there is a basis for it, a disciplinary action.

Mr. FITZPATRICK. I know that we are all wondering how exactly the FDIC would determine that a particular industry was high risk when it produced the original list of industries.

Mr. GRUENBERG. The list that I think is referenced appeared in a journal that the FDIC publishes called the Supervisory Insights journal.

There was an article that I believe appeared in June of 2011 that contained this list. The article was by two of our career employees. And the article was about giving information to banks about managing their relationships with third-party payment processors.

And as part of the article, there was a list that provided identifying categories of merchants that may pose an elevated risk, that banks have to do appropriate due diligence in regard to if they are going to provide services to those customers.

Mr. FITZPATRICK. What type of criteria certified a business, in the eyes of FDIC, to be high risk? What were you using?

Mr. GRUENBERG. The list was drawn, as I understand it—and, for what it is worth, that article appeared before I became Chairman—from similar industry lists that had been compiled identifying merchants that may pose an elevated risk to do business with, as well as experience that the FDIC had through its examination activities.

Mr. FITZPATRICK. And what liability do banks face if they do business with clients that the FDIC determines to be high risk?

Mr. GRUENBERG. As long as the bank has appropriate controls to manage the risk, and as long as the customer itself is doing its business in compliance with the law, there should be no issue.

And frankly, that is why we issued the guidance, to try to make that as clear as we can, and that is why we have adopted procedures to try to ensure that the guidance is being followed.

Mr. FITZPATRICK. Are examiners permitted to tell bank officials that their banks and/or individual employees of those banks may face criminal charges for doing business with particular clients?

Mr. GRUENBERG. Only to the extent that a client should be—if a customer should himself be engaged in illegal conduct, then that obviously poses a risk and a potential liability for the institution.

But I think the point of the guidance we have issued to our examiners is that if they think a bank should not continue a customer relationship, it has to be provided in writing to the institution.

And, in addition, the guidance says two things specifically. One, informal direction should not be provided, it has to be in writing, and the guidance specifically says the reputational risk, by itself, is not a basis for such an action.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman, for the hearing, and Ranking Member Green.

Mr. Chairman, let me ask you a couple of questions. Do you receive any direction from the White House?

Mr. GRUENBERG. No, Congressman.

Mr. CLEAVER. Has the FDIC given any kind of direction to the Department of Justice to investigate financial institutions particularly selected by the FDIC or by you?

Mr. GRUENBERG. As a general matter, no. Depending on the context, if we develop information, we may refer something to the Justice Department.

Mr. CLEAVER. Was the high-risk list a plan to stop banks from doing business with those entities that were listed?

Mr. GRUENBERG. I don't believe so, Congressman. As I indicated, the list that was referred to was from a Supervisory Insights journal article that first appeared back in June of 2011. I think the idea behind the article and the list was to provide information to banks on managing these client relationships.

I will say, as I indicated in my statement, that I do think the list was subsequently misunderstood. There were misimpressions of it, and conclusions were drawn that categories identified on the list were not eligible for banks to do business with, and that is really not the case.

And frankly, the fact that the list was viewed that way, from our standpoint, was a failure on our part. It was the reason we ultimately withdrew the list, because we believed it was being misunderstood and being misapplied, in effect.

Mr. CLEAVER. I appreciate that statement. And I had read your comments on that previous to this hearing.

What I am trying to get clarity on is: Was there some political motive, people moving through the shadows, meeting down in base-

ments with no lights, plotting against businesses that they didn't like and then you and the AG press a button and say, go and get these bad guys and put them on a list of nasty companies?

Mr. GRUENBERG. Not to my knowledge, Congressman.

Mr. CLEAVER. No cigar-smoke-filled rooms with your staff and others in the basement of the White House—

Mr. GRUENBERG. Not to my knowledge.

Mr. CLEAVER. —parked across the street?

Frankly, I am glad that you know the high-risk list. I am hoping that we can deal with this without there being some subliminal reason for this being done other than reasons that I think are fairly clear to us.

One of the roles of this committee is, of course, to try to find out what is going on. And it is our responsibility. So, tough questions are supposed to be asked.

My questions were not particularly tough questions, but they were aimed at trying to hopefully bring some clarity to this whole issue and its genesis.

So I just wanted to find out whether or not you have been secretly meeting with the President either on the basketball court, or on the south lawn of the White House.

Mr. GRUENBERG. No, sir.

Mr. CLEAVER. How often do you meet with the President?

Mr. GRUENBERG. I have had three opportunities during the course of my service as the President each year has met with the financial regulators as a group. And I have had the privilege of participating in those meetings.

Mr. CLEAVER. Did he slip you something to the side on a sheet of paper?

Mr. GRUENBERG. No, Congressman.

Mr. CLEAVER. Okay. I have no other questions. Thank you.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from Tennessee, Mr. Fincher, for 5 minutes.

Mr. FINCHER. Thank you, Mr. Chairman.

I appreciate the questions from the gentleman on the other side of the aisle, but this is a very serious situation for States like Tennessee, where we have a lot of folks who participate and who deliver this product for the consumer.

This is not about one specific business, but this is about the consumer having a product that they can use to help them get by in their day-to-day life.

According to the report by the House Committee on Oversight and Government Reform, 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 that the FDIC had found that activities related to payday lending are unacceptable for an insured depository institution.

So my question is: Explain the legal basis or authority for such a sweeping order in the absence of explicit findings or violations of the law.

Mr. GRUENBERG. Thank you, Congressman.

The letter that you refer to was—

Mr. FINCHER. And I have the letter, also.

Mr. GRUENBERG. I understand.

The quote that you referenced was not consistent with our policy and, frankly, was a mistake and was one of the things that prompted us to be concerned about the misunderstanding of what our policy was and led us in September of 2013 to issue a financial institution letter to clarify that policy.

And the clarification stated that as long as the bank has appropriate controls, and as long as the customer is complying with the law, a bank is neither prohibited nor discouraged from doing business with that customer. So the letter you reference was not consistent with our policy.

Mr. FINCHER. And following up, there seem to still be quite a few banks that are intimidated by all of the goings-on from day one of Operation Choke Point—which you can say it or not. It was political from day one. Even the term is political—are still intimidated to allow businesses to do business with them in regards to maybe a mistake that this letter—or was a mistake.You referenced that.

So what are you doing proactively to get the word out, saying, "It is okay. This is legal. This is okay, to provide banking for these businesses that have done nothing wrong?" That is the problem here. Just because you may not like it doesn't mean it is illegal.

Mr. GRUENBERG. Look, I agree with you. And, Congressman, for what it is worth, we have made multiple efforts now to clarify that to both bankers and to our examiners.

So we issued the financial institution letter in September of 2013 clarifying the policy. We issued a financial institution letter in July of 2014 withdrawing the list and explicitly saying that it is just a question of having appropriate controls by the bank and the customer complying with the law.

Then we issued a statement in January, a public statement, indicating to banks that risks should be determined on an individual customer basis, not on the basis of a category of businesses to which the customer may belong.

We have issued public guidance to our examiners, laying out the specific procedures for our examiners to follow. And we have established and made public both phone numbers and email addresses for our ombudsman and our Inspector General so that if a banker believes that an FDIC examiner is not complying with the procedures—

Mr. FINCHER. Could you provide us with that information?

Mr. GRUENBERG. Yes, sir.

Mr. FINCHER. And just wrapping up—I have 45 seconds left—back to the letter, if it is against your policy to do things like this, then why was this ever done?

Mr. GRUENBERG. I think it was a mistake, frankly, on the part—

Mr. FINCHER. Whose mistake?

Mr. GRUENBERG. —of the author of that letter.

Mr. FINCHER. So are they still with the FDIC?

Mr. GRUENBERG. They are still with the FDIC.

Mr. FINCHER. What was the penalty for making this mistake to go after legal businesses?

Mr. GRUENBERG. As you know, the House Oversight Committee undertook a report. It was one of the items identified in that report. After receiving the report—

Mr. FINCHER. What were the consequences for the actions?

Mr. GRUENBERG. We have requested our Inspector General to review the conduct of the individual there, as well as a number of others, as well as any others that the Inspector General may identify. And that review is currently under way.

Mr. FINCHER. I yield back.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

I am always hesitant to follow my friend from Tennessee, but I will endeavor.

Chairman Gruenberg, several months ago your General Counsel, whose name I think was Osterman—

Mr. GRUENBERG. Yes, Congressman.

Mr. HECK. —sat here and said that legitimately constituted marijuana businesses in those States that have legalized it either through legislative action or vote of the people who followed FinCEN guidance wouldn't have anything to worry about from the FDIC.

Have you formalized that position in writing in any way? Because I have to tell you, I interact with banks and credit unions all the time and they are still walking on eggshells.

Mr. GRUENBERG. Yes, Congressman. We have put in writing in a letter that our direction to banks is to follow the FinCEN guidance.

Mr. HECK. We would deeply appreciate being able to receive a copy of that.

With respect to marijuana producers and dispensaries, as you know, the Department of Justice's Cole memorandum requires conformance with eight Federal priorities to qualify as legitimate. It is important to note the first two: one, keep it out of the hands of kids; and two, keep cash out of the hands of the gangs and cartels.

Both the State entity that regulates them and any bank or credit union that serves them are required to be checking for conformance with the same eight Federal priorities.

Now in my State, where the voters did approve it, we have a State Liquor Control Board which regulates marijuana businesses. They are working with financial institutions to allow banks and credit unions to check the Liquor Control Board's database for red flags before they process any transaction for a marijuana business.

And, frankly, it seems to me this is just a much more effective and efficient way—and we are always looking for efficiencies here—for compliance checks. But, frankly, I worry that it is being undermined because the FDIC insists that banks do their own checks, notwithstanding the fact that we have a regulatory entity that is set up.

It seems to me that you could check how robust and muscular the Liquor Control Board's effort is and sign off for that to be the one-stop shopping by banks so that everybody wins. What is wrong with that idea?

Mr. GRUENBERG. If I may, Congressman, let us take a look at that. And we will be glad to engage with you and your staff in regard to it.

Mr. HECK. I look forward to your response. And I appreciate your willingness to follow up.

I have kind of a philosophical question about Suspicious Activity Reports (SARs). Obviously, it is up to the bank or the credit union to decide whether or not to close a bank account, and I think it should be. So don't interpret my question to mean anything other than that.

But I wonder, frankly, whether or not the mere fact of generating multiple SARs necessarily leads to the best decision to close the account. And why do I say that? Well, that is how we can track them. If we are ever going to want to do anything, that is our access point. That is the transparency.

And if the reaction is if you hit X number of SARS, you are gone, the reality is they either: one, figure out a smarter way to get around indicating reasons to be put on the SARS list; or two, go all cash, thus not benefiting anybody, frankly, and being counterproductive from what we are trying to get at. What is your reaction?

Mr. GRUENBERG. That is probably a tricky call on the part of the institution because, as you know, they are under a legal obligation, if they identify suspicious activity, to report it. So, frankly I would have to give that one a little bit of thought.

Mr. HECK. It is not the reporting. It is the closure that I wonder about. Because it seems to me you just took the teeth out of our ability to enforce.

Lastly, quickly, I want to go all the way back to Wachovia in 2008 and have you just comment briefly on the fraudulent activity you found and stopped.

And, if you recall, how much money was returned to consumers on the basis of your enforcement action?

Mr. GRUENBERG. As you know, Wachovia was a nationally chartered bank under the supervision of the OCC, so I believe it was actually an OCC enforcement action. But we can certainly get that information for you, Congressman.

Mr. HECK. My recollection is it was a very large number with lots of zeros.

Mr. GRUENBERG. It was substantial.

Mr. HECK. Thank you for your service to community and Nation, sir.

Mr. GRUENBERG. Thank you.

Mr. HECK. I yield back the balance of my time.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from Colorado, Mr. Tipton, for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman.

I appreciate you, Chairman Gruenberg, for being here today.

I guess I would like to drill down a little bit in terms of, once you have issued this new guidance and it has gone out to the banks, what are you doing to be able to repair that relationship actually with the customers?

Mr. GRUENBERG. As you know, Congressman, our relationship is with the institution.

Mr. TIPTON. But it was your actions that separated some businesses who had relationships with banks.

Mr. GRUENBERG. And, frankly, that is the issue we are trying to address. I don't know that we can—to the extent there was an impact in the past because of misunderstandings in regard to what our policy was, that is something we regret, and frankly, acknowledge the failure, if there was any consequence of that kind as a result of the list that was issued.

I think our objective now going forward is to ensure that our policy is well-understood and consistently implemented so that any business that is complying with applicable State and Federal law should have access to a banking relationship and that the bank should be clear that there is no prohibition or discouragement in regard to that.

And two points. If an examiner should ever raise a question or recommendation, again, as I made clear, we have now established policies where anything that is directed has to be in writing, the legal and regulatory basis has to be provided, and it can't be simply on some reputational concern, and it cannot be informal.

So we hope there is a sense of accountability here so that the institution—so that it only occurs in appropriate circumstances. And I think—

Mr. TIPTON. I appreciate that.

Part of your mission, obviously, is the safety and soundness of our banks. Businesses have pretty much the same concern for their own safety and soundness. And, arbitrarily, it sounds like, "It was just a big mix-up and, gosh, we made a mistake and we feel bad and now we are going to try and correct it."

But there is institutional damage effectively that you put into place. How are you going to address a bank, if you have a list that you have now wiped away—that is like going before a jury after testimony has been given and saying, "Disregard that." You have already heard it.

Are you going to see a potential problem in terms of those relationships going forward for fear with, maybe, the threat of jail and other penalties going on, the banks are simply not going to handle these businesses as customers?

Mr. GRUENBERG. Look, I hope that is not the case. We are making every effort—I should say, just to be clear, in terms of communicating to our examiners what the policy and expectation is, I met personally with all six of our Regional Directors and, as I indicated, I took part in a nationwide all-hands call for our examiners around the country to make clear both what our policy is and what the procedures are we expect them to follow. We have a very deep commitment to following through on this.

I understand the concerns you raise. If a business is engaging in—

Mr. TIPTON. Do you feel the policies are being implemented now?

Mr. GRUENBERG. We announced the clarification of our policy a year ago. The procedures that I outlined were just announced in January. And I am hopeful and committed that they are going to be effectively implemented.

Mr. TIPTON. I guess, Chairman, the reason I raise this is that the FDIC issued a financial institutional letter in September of 2013, which clarified for employees the institution's policy and supervisory approach. That was followed up 10 months later, in July of 2014, with a second letter restating the policy.

According to the OGR Committee's report during those 8 months, FDIC examiners were discouraging banks from having relationships with short-term lenders.

What is that telling us in terms of effectiveness of policy? Are you going to have to keep revisiting this on a quarterly basis in terms of lining it out to your folks?

Mr. GRUENBERG. I hope not, Congressman. As you know, we received that report from the Oversight Committee, I believe, in December of last year.

And pursuant to that report, there is now an Inspector General review going on both identifying the FDIC's conduct of its policy and whether or not it was consistent with the law and regulation and there were also specific individuals identified whose conduct is now under review by the Inspector General.

So I am hopeful, with these combined efforts, we will be able to address this issue effectively. But I agree that it is going to be an ongoing effort.

Mr. TIPTON. Off of my colleague from Tennessee's question, is this going to be a slap on the hand or are these employees going to be looking at termination?

Mr. GRUENBERG. The Inspector General is reviewing the conduct of these individuals. When that report is submitted, it is ultimately going to be reviewed by our Board.

And it is a review that will not be done unilaterally by me, but I will do it in conjunction with our two inside Directors, Vice Chairman Tom Hoenig and Director Jeremiah Norton.

So the three of us will have the opportunity to review and make a judgment on the facts found by the Inspector General and then, presumably, take action that is appropriate.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from California, Mr. Vargas, for 5 minutes.

Mr. VARGAS. Thank you very much, Mr. Chairman, for the opportunity to speak.

And Chairman Gruenberg, thank you for being here today.

Listening to my colleagues here, we all have very different situations. I represent the border area of California and Mexico. My district literally runs from the ocean all the way to Arizona, so every inch of the California-Mexico border is actually in my district. I also have some areas in San Diego and all of Imperial County.

One of the things that we have done for years is try to get banking services in underserved areas, in poor areas, and certainly one of those areas is along the border. The community of San Ysidro and the community of Calexico in the past had a really difficult time trying to get bank branches to open there. But then they were successful through community efforts, as well, I think, as banks saw an opportunity.

One of the things that you do see along the border, of course, are a lot of cash businesses. And the banks, I think, have flourished

and done well. And, in fact, I don't think we have had—we have had some problems, but nothing out of the ordinary. But you do see a lot of cash transactions.

Recently we have had a lot of banks close their branches there, in fact, a significant amount. I know I had to go and speak to a couple of the banks to beg them to keep some of the branches open. What they are saying is one of the big reasons is because of this Operation Choke Point, that it has been very difficult for them because of that.

Could you comment on that, if you have any knowledge of that, if you could speak to that at all?

Mr. GRUENBERG. Congressman, I have not heard that particular concern raised for institutions in the area that you described. We would be glad and, frankly, would welcome the opportunity to meet with you and your staff to discuss that.

Mr. VARGAS. I would appreciate that very much.

Because, again, these are merchants that have been long-time merchants. These are banks that range from literally small community banks all the way up to very, very large banks with huge deposits.

So it is not your little tiny banks who have had problems in the past. It is, frankly, almost all banks that are leaving the border. And this is the issue that they are pointing at.

So, again, I would like to know what is it that you can do when we meet because that, to me, is a great concern. Again, we have tried for years to bring banks into these areas, the bank people, and we have had an opportunity to do that. And it seems like they are all going away now.

Mr. GRUENBERG. Thank you.

Mr. VARGAS. Mr. Chairman, those really were my questions. And, again, everyone has very different and unique aspects. We don't have marijuana problems. We don't have other issues. But this is a really big problem for us. So I really appreciate you bringing it forward.

Mr. GRUENBERG. Thank you.

Chairman DUFFY. The gentleman yields back. Thank you, Mr. Vargas.

The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney, for 5 minutes.

Mr. MULVANEY. Thank you, Mr. Chairman.

Chairman Gruenberg, I have a letter in front of me dated February 15, 2013. It is signed by Anthony Lowe, one of your Regional Directors at the time. And I am going to read just one or two sentences from it. It was directed to a board of directors at a bank:

"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."

Was this the official position of the FDIC in February 2013 when this letter was written?

Mr. GRUENBERG. Congressman, as I previously indicated, that letter was not consistent with our policy and it was really one of the things that prompted us to issue the guidance clarifying it in September of 2013.

Mr. MULVANEY. If I were to ask you the same question—if I took out the words "payday loans" and inserted "pawnshops," "tobacco shops," "gun dealers," "ammunition manufacturers," would that also be the case? It was not the policy of the FDIC in 2013 and it is not the policy today?

Mr. GRUENBERG. That is correct.

Mr. MULVANEY. And I see that—I don't have the document for later in 2013.I do have the one from July of 2014 that you have referenced here a couple of times today.

In December of 2014, I got a phone call from a pawnshop in my district that had been denied a loan to expand their business. They needed a million dollars to expand their pawnshop.

The woman—it was a single woman who ran it and was hoping to pass it on to her grown children—needed to borrow a million dollars and went to the bank that she had a 25-year relationship with and offered to post $500,000 in collateral and borrow effectively 50 percent of the cost.

She was told by that institution, which was overseen by the FDIC, that they could not lend to her because of the nature of her business. She then went to two other banks in the same community—it is a very small town where I live—and got the same answer.

My specific question to you is this: What remedy is available either to that lady or to that bank for that outcome?

Mr. GRUENBERG. I can't speak to the facts of the circumstance. But if I may try to respond, if indeed that is what occurred, that would not be consistent with our policy. If indeed the banker—

Mr. MULVANEY. Let me ask it this way. Let's say that I talk to the banker and I ask, who is your examiner, and they know and they will tell me. What should that bank do in order to straighten out this difficulty?

Mr. GRUENBERG. I think a couple of things, if the bank is willing. One, to report it to the supervisor, the regional office, to make us aware of it. There is also a dedicated email address to our ombudsman to report it on a confidential basis, or there is also a number and email address to report it to our Inspector General.

Mr. MULVANEY. Now, after you issued the July 2014 advisory letter, the institution letter, you were still having difficulties with Choke Point, weren't you? People were still calling to complain about Choke Point being used to deny them access to credit.

Mr. GRUENBERG. I think it is fair to say we were still hearing concerns.

Mr. MULVANEY. Sure. And that was at least one motivation for the January 2015 additional guidance, correct?

Mr. GRUENBERG. Yes.

Mr. MULVANEY. And you came in—I think the language here says that you encourage—this is from the summary, not the actual text, it is the summary that you provided—insured depository institutions to service the communities. It goes on to say that you encourage them to take a risk-based approach in assessing individual

customer relationships rather than declining to provide banking services to entire categories of customers without regard to the risks. That is in January of 2015.

Last week, it happened again in my district, to a business with a decade's long relationship with their bank, at many different levels, by the way. The company is a diversified company. One of their businesses happens to be payday lending, and their bankers came to them unsolicited. They weren't asking for a new line, weren't asking for any new credit, no new loans, but the bank came to them and said, look, we really like the relationship with you and we want to continue it. We just can't do it anymore for your payday operation. You need to close your checking and savings accounts for that.

Mr. GRUENBERG. Congressman, if the bank is willing, we would certainly—and I understand the concern about reprisal, so it is what makes these situations difficult.

Mr. MULVANEY. That is why I am not using the names.

Mr. GRUENBERG. I understand. But if the bank is willing, we would welcome the opportunity to engage with the institution and understand the facts of the situation.

Mr. MULVANEY. Lastly, and this is the question I referred to, I think, in my opening statement, I have another example that I won't go into in great detail where a similar thing happened in my district with a bank that is not overseen by the FDIC. It is overseen by the Office of the Comptroller of the Currency. So, my question to you is this: Are you aware of any of the other regulatory agencies engaging in similar Operation Choke Point-like activity?

Mr. GRUENBERG. Not to my knowledge.

Mr. MULVANEY. Did you share the directives that you gave in your July 2014 letter and January 2015 letter with the folks at the OCC, with the Fed, or with anybody else?

Mr. GRUENBERG. Those are public documents, Congressman, so they would be available to all the agencies.

Mr. MULVANEY. Thank you, sir. Thank you, Mr. Chairman.

Chairman DUFFY. The Chair now recognizes the gentleman from Maine, Mr. Poliquin, for 5 minutes.

Mr. POLIQUIN. Thank you for being here, Mr. Chairman. This report from last year concludes that your agency and the people who work for you had a list of firms, of businesses that were questionable, disreputable. And you folks instructed your examiners with a directive listing this group of businesses that were questionable, disreputable in the opinion of your examiners or the folks that you work with in the front office, and instructed banks to put pressure on—or the examiners to put pressure on those banks so they would not extend loans and debit transaction processing and so forth and so on to try to presumably drive these businesses out of business.

Now, what do you say to a three-generation family business outside of Bangor, Maine, that I represent, that sells firearms and ammunitions legally, and also sells tobacco, maybe they sell some fireworks—I'm not done yet. Sorry.

Mr. GRUENBERG. I don't—

Mr. POLIQUIN. Thank you. What gives you the right, or anybody who works for you the right, or your agency the right, to tell businesses who are operating legally in this country, where the owners

have sacrificed their savings, their hard work, grown their businesses, hired their family members and others—what gives you the right to try to shut them down, sir?

Mr. GRUENBERG. We don't have that right or authority, Congressman.

Mr. POLIQUIN. You don't, but you did it, didn't you?

Mr. GRUENBERG. That is something we have now asked our inspector—

Mr. POLIQUIN. But you did it, didn't you, sir?

Mr. GRUENBERG. I am trying to—

Mr. POLIQUIN. Please. I have 3 minutes left.

Mr. GRUENBERG. I understand the findings from the House Oversight Committee report, and as a result of that report, our Inspector General is conducting a review.

Mr. POLIQUIN. If I am not mistaken, sir, based on the timeline that I have, there was a period of time where you asked for this list to be expanded; is that correct?

Mr. GRUENBERG. Not to my knowledge.

Mr. POLIQUIN. That is not correct. I want to make sure I hear this correctly.

Mr. GRUENBERG. I am not sure what you are looking—

Mr. POLIQUIN. You did not ask for this list of questionable businesses ever to be expanded; is that correct?

Mr. GRUENBERG. I think I—if I may note, if I may say what I think you may be referencing.

Mr. POLIQUIN. It is a very simple question.

Mr. GRUENBERG. No, if I may answer. I will try to.

Mr. POLIQUIN. Please.

Mr. GRUENBERG. The list that you are referencing appeared in a Supervisory Insights Journal article.

Mr. POLIQUIN. That is correct, which is a directive to examiners dealing with banks, correct?

Mr. GRUENBERG. That is an article that is not actually guidance but it is informational to the industry—

Mr. POLIQUIN. Certainly, they get the message. Did you in fact—

Mr. GRUENBERG. No.

Mr. POLIQUIN. You did not ask to expand this list to include firearms dealers?

Mr. GRUENBERG. No, sir. There was guidance issued in January of 2012, following on that Supervisory Insights Journal article, and there was a—in that guidance, there was a—identified some examples.

Mr. POLIQUIN. As I understand your answer, you did not in any way, at any time, ask to expand this list of industries?

Mr. GRUENBERG. To expand—

Mr. POLIQUIN. That is what I heard.

Mr. GRUENBERG. Not to my knowledge.

Mr. POLIQUIN. Okay. Fine. Thanks. Let's move on. There is a pattern here, Mr. Director, of government agencies, like the Internal Revenue Service, intimidating law-abiding citizens because they don't have the same political views as maybe the regulating agency, and the Administration wanting to give amnesty to 5 or 6 million people which is not set in law, and now all of a sudden you folks come along.

I think you folks, frankly, are a threat to our economy and our way of life and the employment that we have in this country. What do you say to the employees who have lost their jobs because of the overreach of your agency asking examiners to intimidate banks to shut down credit to businesses that are trying to survive? What do you say to those families who have lost those jobs?

Mr. GRUENBERG. To extent it has occurred or an issue, it needs to be addressed, and we have asked the inspector—

Mr. POLIQUIN. But we just heard that the folks who were involved in this mess are still working at your agency; is that correct?

Mr. GRUENBERG. Yes.

Mr. POLIQUIN. That is correct. Okay. So when did you find out about this?

Mr. GRUENBERG. The report that you reference was released in December.

Mr. POLIQUIN. When did you find out about it, sir?

Mr. GRUENBERG. About the allegations that you are raising, I believe when we received the report, and pursuant to that, we requested the Inspector General to review the conduct.

Mr. POLIQUIN. Okay. So how long have these people who were involved in this mess, how long have they still been working at your organization?

Mr. GRUENBERG. These are career employees.

Mr. POLIQUIN. I don't care who they are. How long has it been, since the report came out, that they are still working there?

Mr. GRUENBERG. The report came out in December and this is March.

Mr. POLIQUIN. Okay. Thank you.

Chairman DUFFY. The gentleman's time has expired. The Chair now recognizes the gentleman from Minnesota, Mr. Ellison, for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman, and Ranking Member Green. Mr. Gruenberg, I represent a district in Minneapolis, Minnesota, the 5th District of Minnesota. It is home to America's largest Somali American population. We are very proud of our community, and they make tremendous contributions to our society every day. But one of the problems that they are facing is that the money that they earn that they try to remit back home through Somali money service businesses is being reduced tremendously. Is this phenomena where we see the MSBs having their options cut part of Operation Choke Point?

Mr. GRUENBERG. I don't believe so, Congressman.

Mr. ELLISON. Now, when you say you don't believe so, are you saying that it could be but you just don't know about it, or just—I am not trying to be difficult.

Mr. GRUENBERG. Sure, sure.

Mr. ELLISON. It is just like I am like, I would far and away prefer yes or no, and do you understand what I mean, because when you say you don't believe so—

Mr. GRUENBERG. No, no.

Mr. ELLISON. Okay. So no, it is not. I want to say thanks for the FDIC's statement about serving money service businesses. What kind of feedback did you get from your regulated financial institu-

tions about the statements that you all put out, and did they think that the statements added clarity or increased understanding?

Mr. GRUENBERG. I would say the general response has been positive because it both clarified the policy, and we hope our procedures will ensure that it is followed.

Mr. ELLISON. Okay. And were the banks more willing to provide checking accounts and/or wire transfers to money service businesses serving vulnerable nations because of your statement, as far as you are aware?

Mr. GRUENBERG. I can't speak to that, Congressman.

Mr. ELLISON. Okay. And there seems to be a disconnect between what Treasury and FinCEN say and what examiners tell banks specifically about know-your-customer requirements. Banks believe that they must know their customer's customer even though FinCEN and Treasury say that is not necessary. Do you want to—do you have any reflections on that?

Mr. GRUENBERG. Yes. I agree with what you—in regard to the FinCEN position that the obligation is to know your customer and not to know, as you say, the customer of your customer.

Mr. ELLISON. Right. So, I have talked to a lot of bankers about this problem, and what they tell me is that they feel the need to be infallible even though infallibility is not a required standard. Do you think there is a disconnect or do you think that the rules are very clear? Do you think there is some more clarity that we could be doing?

Mr. GRUENBERG. We actually issued guidance trying to clarify that point that this is not a no-fault or no-mistake system. We understand that mistakes may be made. The issue is, do they have an appropriate set of controls and policies? It is not a mistake-free environment. We understand that. And we tried to make that clear in our guidance.

Mr. ELLISON. Is the FDIC part of any interagency working group to restore remittances pipeline?

Mr. GRUENBERG. I believe there is an interagency effort, and we have participated in that.

Mr. ELLISON. Can you give me some assessment about how well that interagency group is working?

Mr. GRUENBERG. I think it is receiving serious attention. As you know, it is a challenging issue, so I don't know that we have a solution yet, but I think it is going to require a high-level effort among the agencies in conjunction with Treasury and the State Department as well, I expect. And I know you have been leading that effort.

Mr. ELLISON. Yes. Has the FDIC engaged with the working group on remittances to East Africa convened by the Federal Financial Institutions Examination Council (FFIEC)?

Mr. GRUENBERG. Yes. I would have to check on that, if I might, Congressman.

Mr. ELLISON. Yes.

Mr. GRUENBERG. I don't know.

Mr. ELLISON. You could respond to that in writing. Do you know anything about the FFIEC?

Mr. GRUENBERG. Yes. We are a member of the FFIEC.

Mr. ELLISON. Okay. Do you think that they can make a contribution toward restoring humanitarian remittances? Do you think they are an important player to have involved?

Mr. GRUENBERG. Yes, I do. They represent, as you know, the regulators of the insured depository institutions.

Mr. ELLISON. Okay. All right. I think that is pretty much the end of my time. So, I want to say thank you, and any other additional questions, we will submit in writing.

Mr. GRUENBERG. Thank you, Congressman.

Mr. ELLISON. I yield back. Thank you, Mr. Chairman.

Chairman DUFFY. The gentleman yields back. The Chair now recognizes the gentleman not from North Carolina but from Texas, Mr. Green.

Mr. GREEN. Thank you.

Chairman DUFFY. For 10 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I think it is appropriate to give some indication as to why it is important for us to be concerned about activities of the third-party processors as they relate to the banking industry. For clarity purposes, these third-party processors, as they are called, are businesses. And these businesses, for a fee, will accept payments from consumers, and they accept these payments and they give these payments, they deposit them in banks for merchants, and it is a good business. There is nothing illegal, per se, about third-party processors. There is nothing illegal, per se, about the businesses that have been mentioned today.

But I do think that we have had some things occur that have caused us to take a look at this process. And quite frankly, I think the American people would want us to look into these things based upon some of the past occurrences.

So, let's take a look at a few of them. On March 12, 2015—and I am not going to mention the name of the bank, but if someone wants me to, I will—a bank paid $1.2 million in fines for knowingly facilitating consumer fraud. Consumer fraud, meaning people, people from our congressional districts were defrauded. It happened. It cannot be ignored.

In April 2014, a bank—name not mentioned but available if need be—paid $1.2 million in fines for fraudulent charges made by a third-party processor. Another fine paid, $1.2 million.

On March 10, 2015, a bank paid $4.9 million in fines. The processor was allowed, in this case, to make hundreds of thousands of withdrawals over a 20-month period on behalf of a telemarketing company that charged unauthorized payday loan referral fees. Now, this would give the payday loan industry a black eye, a bad reputation to allow something like this to occur and not take action. There is no effort on the part of the FDIC to eliminate payday lending, but I do think that when we see these egregious circumstances, we have to do something. The banks should not just simply be a party to this by seeing it occur and not do something affirmative to stop it. They are there, they know that these things are going on, and they should take affirmative action, and they should have a compliance process in place. And when they do not, I think that should be called to the attention of banks, and that is really what the FDIC appears to be doing.

And here is one. In November 2012, a $15.5 million settlement—2 million fraudulent charges by a third-party processor. Two million. These are people who are being hurt. I do appreciate what my colleagues have said about the businesses, and businesses who are operating legitimately should in no way be challenged about what their lawful business operations are, but there is a reason why we are looking into things in this area.

And I want to thank you, Chairman Gruenberg, for the way you have aggressively made an effort to correct mistakes that were made. I have some of your testimony, and you did not go into any great detail, but I would like for you to respond. It appears to me that you participated in a national call with all FDIC supervision staff. Tell us about that call and what you were attempting to accomplish with that call, please.

Mr. GRUENBERG. Thank you, Congressman. As I indicated previously, we wanted to be sure that our examiners are implementing the policy that we have announced and clarified, which is that banks are neither prohibited nor discouraged from serving the customer as long as the customer is in compliance with State and Federal law and the bank has the appropriate procedures and controls. And we established a set of processes for examiners to follow in implementing the policy. I don't want to repeat it all again, but it has to be in writing, it has to cite the regulation and law, it has to be approved by the Regional Director, and ultimately, any actions have to be reviewed by our Board.

I took part in that nationwide all-hands call with all of our examiners nationwide to emphasize the importance both of the policy and of the importance of implementing the procedures to ensure that the policy is faithfully implemented. And I am very committed to this. I understand the concerns that have been raised. It is a balance that you have to strike here in that we want banks that have appropriate controls, and customers who are abiding by the law to have access to banking services. At the same time, we want banks to have an appropriate set of controls to identify any improper activity that may be going on. So, it is a balance to strike. It is what we are trying to do.

Mr. GREEN. You also met with the six Regional Directors. This is something you did yourself to make clear what the policy was in the event someone was unclear. Would you kindly give us some intelligence on this?

Mr. GRUENBERG. Consistent with the call to all of our examiners, I met with our six Regional Directors who oversee our examiners around the country. Again, to emphasize the importance of and make clear the policy and the procedures that we are implementing to ensure that the policy is followed.

I wanted to send that message from me directly both to our Regional Directors as well as to our examiners.

Mr. GREEN. You have mentioned it, but I think some things bear repeating. Toll-free numbers that you have made available, at least two. Would you reiterate, please?

Mr. GRUENBERG. As I indicated, follow-through in implementation is really what is important here. That is the reason for the calls and the meetings and establishing the written policies. And we wanted to give bankers a recourse, that is, if they think an ex-

aminer is not acting appropriately, not following the policy, not implementing the procedures, we wanted to give them a confidential way to report that.

So we provided, in our public statement, a phone number and email address for our ombudsman, as well as a phone number and an email address for our Inspector General so that any banker who believes an examiner is not doing what they should be doing can report it on a confidential basis.

And frankly, I would hope the banker would make the effort to report it to our regional office so that we can act on it directly, but I understand the concern and desire of some bankers for confidentiality, so we wanted to give them an avenue to report the information on a confidential basis.

Mr. GREEN. And the notice process to banks has now been not only formalized but it has been codified, and you have made it clear that this is to be done in writing. There will be no informal conversations that will be recognized. We all have some people who don't adhere to the letter and spirit of policy, but you have made it clear to people that your expectations are that policy will be followed to the letter and in the sincerest spirit with which the policy was promulgated. Is that a fair statement?

Mr. GRUENBERG. Yes, I think so, Congressman.

Mr. GREEN. Would you want to add anything more to this list of things that you have done to make sure that mistakes are properly addressed?

Mr. GRUENBERG. Just to be clear, the procedures that you just described we put in writing, they are public, and our examiners are expected to follow it, and the procedures make clear it has to be in writing. It cannot be in informal communication, and that reputational risk, by itself, is not the basis for an action. So, we have tried to be responsive to the concerns that have been raised.

Mr. GREEN. Thank you, Mr. Chairman. I will reserve my final 5 minutes.

Chairman DUFFY. The gentleman yields back. The Chair now recognizes himself for 15 minutes.

So, Chairman Gruenberg, I want to be clear on your testimony. The FDIC, by way of its list that came out in Supervisory Insights, this was not a target list by the FDIC; that is correct, right?

Mr. GRUENBERG. I don't believe that was the intention.

Chairman DUFFY. Yes or no? You are the Acting Chairman. This is not a target list.

Mr. GRUENBERG. For what it is worth, that article came out before I became Acting Chairman.

Chairman DUFFY. So, this is not a target list then, for your testimony?

Mr. GRUENBERG. I'm sorry?

Chairman DUFFY. This is not a target list?

Mr. GRUENBERG. I don't believe it was, no, Mr. Chairman.

Chairman DUFFY. Okay. And your testimony is that at no point during your chairmanship has this list been used to target these groups that are enumerated on the list, right?

Mr. GRUENBERG. It would not have been consistent with our policy.

Chairman DUFFY. Not consistent with your policy. What has been the practice of the FDIC?

Mr. GRUENBERG. I believe the general practice has been consistent with that policy. There may have been instances, and that is, frankly—

Chairman DUFFY. How prevalent are those instances where the practice of the FDIC hasn't been followed?

Mr. GRUENBERG. We don't know that, frankly. That is what the inspector is—

Chairman DUFFY. You are the chairman, right?

Mr. GRUENBERG. Yes, and that is what the—

Chairman DUFFY. Have you been looking into this yourself?

Mr. GRUENBERG. We have asked the inspector—

Chairman DUFFY. That is not my question. Did you look into it yourself?

Mr. GRUENBERG. When the—

Chairman DUFFY. Have you looked into the abuses of people who haven't followed your policy at the FDIC?

Mr. GRUENBERG. When the House—

Chairman DUFFY. Have you—

Mr. GRUENBERG. I am trying, if I may.

Chairman DUFFY. Yes or no?

Mr. GRUENBERG. The answer, I would say—

Chairman DUFFY. Yes. The answer is no, right, you have not looked into it?

Mr. GRUENBERG. I have looked into it, and the determination—

Chairman DUFFY. What have you found?

Mr. GRUENBERG. I am trying to answer.

Chairman DUFFY. I am trying to get an answer.

Mr. GRUENBERG. The determination we made in conjunction with our inside Directors is this would—we needed to get the facts, and that is really the basis for the Inspector General review.

Chairman DUFFY. How long have you been looking at the facts?

Mr. GRUENBERG. Well, the report of the House Oversight Committee—

Chairman DUFFY. No, no, no, no, no. You gave information to the Oversight Committee.

Mr. GRUENBERG. Yes.

Chairman DUFFY. You had that information. You have known for 2 years that this was going on. What have you done in the last 2 years to address Operation Choke Point or the targeting of these businesses?

Mr. GRUENBERG. We issued guidance in September of 2013. We withdrew the list in July of 2014. We have issued additional guidance, and we have also asked the Inspector General to—

Chairman DUFFY. You have given new guidance, right. So let's—you were asked from some of my colleagues about a letter that came out from Anthony Lowe, and in there—this was February 15, 2013, and I am not going to read the full egregious paragraph, but just the end it says, "Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution." Now, is Mr. Lowe still employed at the FDIC?

Mr. GRUENBERG. Yes, he is.

Chairman DUFFY. Yes, he is. And is he still in the same position, as Regional Director?

Mr. GRUENBERG. Yes.

Chairman DUFFY. And is it part of your policy now that if you have an issue with one of your banks, you should go to the Regional Director Mr. Lowe? Yes?

Mr. GRUENBERG. Yes.

Chairman DUFFY. Yes. Do you think a bank is going to feel comfortable having an examiner that is going after them for payday lending to go to Mr. Lowe who is targeting payday lending?

Mr. GRUENBERG. And the—

Chairman DUFFY. That is your big answer to targeting payday lenders?

Mr. GRUENBERG. I think, as you know, the Inspector General is currently reviewing—

Chairman DUFFY. I don't care about—

Mr. GRUENBERG. If I may just answer.

Chairman DUFFY. Is the Inspector General the Chairman of the FDIC or is it Martin Gruenberg? The buck stops with you, Mr. Gruenberg.

Mr. GRUENBERG. Yes, and it was important to us to get the facts in the case before taking any action.

Chairman DUFFY. So, you have these facts, this letter, and you have done nothing, right?

Mr. GRUENBERG. We have taken the actions I described, Mr. Chairman.

Chairman DUFFY. So, what you have done is, in the last 2 years you have waited for the Oversight Committee to do a report, then you asked for an IG investigation. So this is classic slow walking. He is still in this position. And we will get to, I think, what the truth is behind what is happening here.

I want to go through just a few more documents to make sure we are on the same page and how prevalent this work at the FDIC is. Thomas Dujenski—I am saying his last name wrong. He no longer works at the FDIC, right?

Mr. GRUENBERG. Yes, sir.

Chairman DUFFY. Was he fired or did he leave on his own accord?

Mr. GRUENBERG. He retired, I believe.

Chairman DUFFY. He retired, he wasn't fired. Here is an email from February 7th: "I am pleased we are getting the banks out of the payday bad practice," et cetera. "Another bank is griping, but we are doing good things for them. For example, the redacted bank, is going the hate DOJ being involved. We are doing the right thing for sure. One or two banks may complain next week when the Florida bankers come to D.C. as a group."

So we have old Thomas, we see how he feels about payday lending, but he retired, wasn't penalized at all. Thomas again says that he literally can't stand payday lending. That was in an email on November 26th. Let's see, we now have Seth Rosebrock: "Jonathan, heard where you are coming from, but nonetheless, wants to retain a reference to pornography in our letters and slash talking points. He thinks it is important for Congress to get a good picture regarding the unsavory nature of the business at issue. He represented

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 online lenders and gaming businesses will ultimately help get the message at issue." Have you seen this email?

Mr. GRUENBERG. Yes, I have.

Chairman DUFFY. Would that disturb you?

Mr. GRUENBERG. Yes.

Chairman DUFFY. Was Seth reprimanded?

Mr. GRUENBERG. Well, the—

Chairman DUFFY. Is Seth still employed at the FDIC?

Mr. GRUENBERG. No, no. Just so I understand, I think that email was referencing a comment by—

Chairman DUFFY. Jonathan.

Mr. GRUENBERG. —the individual you mentioned.

Chairman DUFFY. Is Jonathan still employed at the FDIC?

Mr. GRUENBERG. Yes, and his conduct is under review as well.

Chairman DUFFY. Have you done anything to—has he been reprimanded by you, the Chairman?

Mr. GRUENBERG. Not—

Chairman DUFFY. No?

Mr. GRUENBERG. —until we get the facts in the case, Mr. Chairman.

Chairman DUFFY. These are pretty—and he is still in the same position. He hasn't been demoted, right?

Mr. GRUENBERG. No. I think the view of myself and the other inside Directors was we wanted to get the facts in the case before making a judgment in regard to an employee.

Chairman DUFFY. Dana Lesemann, she says that although payday lending is a particularly ugly practice—and it goes on, but I am sure Dana is still employed and not been reprimanded. Here is one. Do you know an individual by the name of Mark Pearce?

Mr. GRUENBERG. Yes.

Chairman DUFFY. High ranking at the FDIC?

Mr. GRUENBERG. Yes.

Chairman DUFFY. Okay. This was from Marguerite, and I always have a hard time with Marguerite's last name. You know Marguerite, correct, though?

Mr. GRUENBERG. Yes.

Chairman DUFFY. Yes. Marguerite says, "Second, at the request of Mark Pearce, we are looking into the avenues by which the FDIC can potentially prevent our banks from facilitating payday lending."

Mark Pearce, we are looking into avenues by which the FDIC can potentially prevent our banks from facilitating payday lending. Chairman Gruenberg, Mark Pearce is at almost the top of the pyramid. Is he still employed at the FDIC?

Mr. GRUENBERG. Yes, he is, Mr. Chairman.

Chairman DUFFY. Has he been reprimanded by you?

Mr. GRUENBERG. We are awaiting the results of the—

Chairman DUFFY. Waiting for—

Mr. GRUENBERG. —IG's review of his conduct.

Chairman DUFFY. This was sent in 2013. This was 2 years ago. I am not going to go through all of the emails, but I would argue that if I were you, the Chairman, and I actually agreed with the

targeting of payday lending, I would say, you know what, I am going to slow walk it. I am not going to do anything, and what I am going to do is I am going to hang my hat on the fact that an OGR report came out with all my documents, and then I am going to look for an IG investigation, and I can slow walk this thing, and all the while payday lenders across the country that are legal businesses, right, they are legal? Yes or no, payday lending is legal?

Mr. GRUENBERG. Yes. I was—

Chairman DUFFY. They follow the law.

Mr. GRUENBERG. There are some States, as you know, that don't permit it, but—

Chairman DUFFY. They follow the law, they are legal.

Mr. GRUENBERG. Yes.

Chairman DUFFY. Are gun dealers, if they follow the law, legal?

Mr. GRUENBERG. Yes.

Chairman DUFFY. Are ammunition manufacturers, if they follow the law, legal?

Mr. GRUENBERG. Yes.

Chairman DUFFY. So you haven't—the people that I have mentioned, you haven't fired any of them, right?

Mr. GRUENBERG. That is correct.

Chairman DUFFY. I want you to look behind you. On the second row I have a number of people from all across the country, gun dealers, ammunition manufacturers, payday lenders, who have been targeted by your people at the FDIC, and guess what, they are going out of business. Do you want to look at them?

Mr. GRUENBERG. Yes, I did.

Chairman DUFFY. Did you see them on the way in?

Mr. GRUENBERG. I saw them when I came in, Mr. Chairman.

Chairman DUFFY. And what response do you have to them, when these small business owners, who invested their life savings, who have worked their hearts out, and all of a sudden they can't find a bank to bank them because you say, not by way of the FDIC official policy, but all my top level people, they have targeted their sectors, they can't find banks, and they are going out of business, what do you say to them?

Mr. GRUENBERG. As far as our conduct, we have made every effort to make our policies clear, that if the businesses are conducted in compliance with the law, they should—

Chairman DUFFY. Well—

Mr. GRUENBERG. If I could just—

Chairman DUFFY. Go ahead.

Mr. GRUENBERG. They should have access to banking services. To the extent individuals may have acted inappropriately, that is currently under review by our Inspector General, and if there was misconduct, that will be then subject to a review by myself and the inside Directors at the FDIC.

Chairman DUFFY. So, what you say is, yes, I knew 3 years ago, and I am just going to act now with an IG investigation after the OGR report. And these people are still going to collect fat salaries in their cushy positions, but the small business owners behind you, they are all going to be out of work, no job for them, and you call that fair.

I don't, Mr. Gruenberg. I think you are the Chairman, and I think, if I recall in your introduction, did you go to Princeton?

Mr. GRUENBERG. I did, sir.

Chairman DUFFY. You are a very intelligent guy. And I am sure that if you wanted to hold accountable those who were bad actors in the FDIC, you would. I don't think you want to hold them accountable.

Let's just talk a little bit further about what the FDIC has been doing with regard to its policies. From Thomas Dujenski, August 1, 2013, this is a consent order. So, we talk about payday lending. By chance, did you ever look through some of these consent orders that were sent to our committee?

Mr. GRUENBERG. I would have to know which ones you are referring to.

Chairman DUFFY. We redacted the bank, but it is a consent order, and in regard to the consent order, official document, not an email, the prohibited businesses—and do you know what the definition of "prohibited" is?

Mr. GRUENBERG. I don't know the document you are referring to.

Chairman DUFFY. No, the definition of "to prohibit."

Mr. GRUENBERG. Yes.

Chairman DUFFY. What is the definition? Do you know?

Mr. GRUENBERG. I don't know the context. I just don't know the context in which it is being used there, if I may.

Chairman DUFFY. Okay. Well, prohibited businesses, ammunition sales, and firearm sales. This is in a consent order with a bank. So, this is the official policy of the FDIC?

Mr. GRUENBERG. Again, I would have to see the document.

Chairman DUFFY. I will send it down if you want, but it is—you sent it to me.

Mr. GRUENBERG. Sure.

Chairman DUFFY. So, what do you say about a consent order for a bank that says you can't do business, it is prohibited with ammunition manufacturers and gun dealers?

Mr. GRUENBERG. You know what, I would need to see the document, and I would be glad to review it and get back to you, if that would be helpful.

Chairman DUFFY. I will send it down in a moment. I have another one. I have a commercial lending policy dated March 14, 2012, undesirable loans. Undesirable loans. Guess what is on that list? Undesirable loans include firearm dealers, and you wonder and scratch your head, why are firearm dealers around America going out of business? Because the FDIC is targeting banks and saying you can't do business with them.

Let's try one more. Anthony Lowe, who is still employed at the FDIC, right? This is a memorandum of understanding on April 2, 2014. When did you order your directive to stop targeting folks and make sure everyone at the FDIC was clear that this was not a target list? When was that sent out?

Mr. GRUENBERG. We issued guidance in September of 2013 making clear what the policy was, and then we withdrew the list in guidance issued in, I believe, in July 2014.

Chairman DUFFY. So in September of 2013, you were clear that you are not supposed to target these whole lines—these whole businesses, right?

Mr. GRUENBERG. I think that was never our policy, and we wanted to be clear that—

Chairman DUFFY. Sure.

Mr. GRUENBERG. —that was the case.

Chairman DUFFY. And Mr. Lowe did a memorandum of understanding, and on that list, he has prohibited acts and services, and on there is payday lenders. How could that be? That is after you gave the guidance.

Mr. GRUENBERG. I would have to look at the documents you are referring to, Mr. Chairman.

Chairman DUFFY. You don't trust me. You gave them to me. They are your documents.

Mr. GRUENBERG. I want to know which one you are—

Chairman DUFFY. We have 2 minutes. Do you want me to send them down to you so you can look at them?

Mr. GRUENBERG. What I would suggest, if you are okay with it, is if we could have an opportunity to review them and then we will get back to you.

Chairman DUFFY. I don't think there is an explanation for it. I would say you would be hard pressed, even with a Princeton education, that you have consent orders and memos of understanding that say you can't do business with ammunition manufacturers, gun dealers, and payday lenders. These are the official documents of the FDIC going out to banks.

And I have an email chain showing that you are targeting payday lenders and ammunition manufacturers. You are abusing your power. You are going after little guys all over America because, I would say, Mr. Gruenberg, you are a good liberal. You say, I don't like these industries and I am going to use, just like Lois Lerner, the power that I have at the FDIC to target these industries, and I am going to put them out of business. And I am not going to have a public debate because people like the Second Amendment and they like their guns. I am going to do it behind closed doors under the cover of darkness and put these folks out of business as a bureaucrat and as an activist instead of saying, you know what, I am going to come clean and have a public debate.

The bottom line is you are putting people out of business. And all the people, in the end, in the FDIC who are implementing this program, they still work there. They haven't been fired. They haven't been reprimanded. And you are the Chairman. And frankly, I will tell you what, if you are not going to hold them accountable, I think the buck stops with you. I don't think you should chair the FDIC.

If you can't go after and root out the problems in the FDIC, if you can't hold accountable those who are targeting legal businesses, you have no place as the Chairman. That you have known for 2 years that this is going on. That you wait until we make public the documents that you gave us, and then you do an OGR report, or an IG investigation and you say, you know what, after I get those results, I am going to take action. All the while, Americans are getting targeted, and frankly, I think irresponsible, and

if you are not going to handle it, I don't think you should keep your position. Do you want to respond?

Mr. GRUENBERG. Yes. Well, Mr. Chairman, we have tried consistently, going back to when we received the letter from the Members of Congress, to respond to the concerns that have been raised. We have tried to clarify our policies. We have tried to address the issues raised by the list.

We cooperated with the investigation of the House Oversight Committee. When we received the results of that investigation and the report, we then tried to take action pursuant to it, both to the policies of the FDIC as well as to the individuals raised.

And in regards to the individuals—and I will say that all of the actions that we have taken over this period of time are done in consultation with our Vice Chairman. We have tried to do it on a basis that involves our Board, and we intend to work together to review the findings of the Inspector General.

So, we have tried, from my standpoint—I understand the points you make—to take a balanced approach to address this—

Chairman DUFFY. These people have no place in the government.

Mr. GRUENBERG. —in a responsible way.

Chairman DUFFY. I am going to yield in a second. These folks have no place in government. And if you allow them to stay, you have no place in government. With that, my time has expired.

With that, I see that the gentleman from Missouri, Mr. Luetkemeyer, has arrived. We will recognize him for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I thought I had 12 minutes there for a minute. Okay. Down to 5 minutes.

Mr. Chairman, it is good to see you again.

Mr. GRUENBERG. Thank you.

Mr. LUETKEMEYER. I just have a couple of follow-up questions with regards to some of the discussions we have had. You indicated in your meetings with us, and I think, just for the record, in your testimony today you indicate that on August 13th you received a letter from Congress and you took some action. In July of last year, you did something, you took some action. In January of this year, you took some action. But it takes us to get you to do anything, and it is very concerning, because Choke Point is something that I think the chairman has done a good job of explaining is, to the detriment of all of our citizens, all of our businesses in this country, which is a—it is basically your own moral judgments and political ideology that is being perpetrated as a result of—through the rulemaking that you—and the enforcement actions that you take.

One of the things that we discussed at our last meeting, and something that is in your testimony today, is the new procedures that you said you agreed to. One of them was that anytime a—you were to request that a bank would terminate a relationship with one's clients, you would do it in writing and indicate so with showing the legal reason for that, excluding reputational risk, and then have a VP, regional VP sign off on that. How many have you done so far since our meeting in January when you implemented these changes? Do you know?

Mr. GRUENBERG. I don't know that there—at the first so—and we have also provided that for any actions taken there be a quarterly report to our Board.

Mr. LUETKEMEYER. I understand that. I thought maybe you might have a monthly report to share with us.

Mr. GRUENBERG. No, we will have that first report in April. We will be glad to share that with you, Congressman.

Mr. LUETKEMEYER. Okay. Another question with regards to the FDIC Board, can you tell us who the Board Members are?

Mr. GRUENBERG. Yes. We have 5 Board Members. If you would like me to name them?

Mr. LUETKEMEYER. Sure.

Mr. GRUENBERG. Vice Chairman Thomas Hoenig, and Director Jeremiah Norton, who are our two so-called inside Directors full-time at the FDIC, and then as a matter of law, the Comptroller of the Currency, who is now Thomas Curry, and the Director of the Consumer Financial Protection Bureau, Richard Cordray, who are also so-called outside Directors and Members of our Board.

Mr. LUETKEMEYER. Have you shared these Choke Point activities with your Board?

Mr. GRUENBERG. Certainly with the two inside Directors, yes, because these are matters that generally go to the internal management of the agency and are generally the focus of the attention of the internal Directors.

Mr. LUETKEMEYER. But you have not shared this activity with the Comptroller of the Currency or the Director of the CFPB, Director Cordray?

Mr. GRUENBERG. I believe they are also aware of it, Congressman.

Mr. LUETKEMEYER. No, there is a big difference here. That is the reason for my question. Did you inform them of what your activity is here? This is Operation Choke Point. This is an operation within your agency that is condoned by you and all the activities that go on at the agency, and this should be something that should be at a Board level. You should be indicating it to your Board Members that this is happening. Did you do that?

Mr. GRUENBERG. I would have to check on—I believe they are aware. Certainly all the documents we have issued relating to guidance are public documents that are available, and we certainly made an effort to ensure Board accountability for these actions, so let me—let me get—if I may get back to you on that.

Mr. LUETKEMEYER. Okay. I am concerned because I think they all need to be aware of it, and we had testimony of one these gentlemen. They didn't hear of it, didn't know of it, weren't aware of it.

Mr. GRUENBERG. I certainly agree with that, Congressman.

Mr. LUETKEMEYER. It would seem to me that is where we certainly need to go with some of this stuff.

I guess just a follow-up on the chairman's last comments with regards to—and we have had this discussion, Mr. Chairman—the culture that you have allowed to happen in the FDIC. How do you propose to solve the problem at this point?

Mr. GRUENBERG. Through the efforts that we have made and I have described at the hearing and we have talked about in our conversations as well. We have made every effort to make our policy clear. We have—clearly, there was a misunderstanding in regard to the list, which we acknowledge was a mistake on our part and we

have withdrawn the list. As you indicated, we have established a set of procedures, written procedures for examiners to follow and to provide in writing any explanation of any actions in regard to a bank, and we have issued a statement in regard to derisking, that any actions by a bank should be based on the individual customer, not in regard to any category of business. And I have engaged in extensive outreach with our—both Regional Directors and our examiners around the country to try to make the policy and procedures clear.

Mr. LUETKEMEYER. But so far nobody has been fired, nobody has been demoted. The OGR report that shows there are people making statements like, we need to audit you, or threaten banks that, we will audit you if you don't comply with what is going on here, or these—certain industries don't have a moral right to exist, those people are still employed?

Mr. GRUENBERG. They are, but their conduct is also currently subject to review by the Inspector General.

Mr. LUETKEMEYER. Okay. If the chairman will indulge me with one more question. In your changes that you made, operational changes you have made, you also indicated that there would be a Web site and a hotline number for the IG.

Mr. GRUENBERG. Yes.

Mr. LUETKEMEYER. To be able to report activities. Have any activities been reported to this point?

Mr. GRUENBERG. We established numbers and email addresses for both the IG and our ombudsman. Any reports to the IG are to the IG and are not available to us.

Our ombudsman has shared the—some of the results which—that the ombudsman has received, and I believe since the number and address—email address were made public, we have had 12 emails and 3 calls.

Chairman DUFFY. The gentleman's time has expired.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Chairman DUFFY. The Chair now recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Mr. Chairman, if I may, I would like to have just a quick word with you.

[Discussion off the record.]

Chairman DUFFY. I appreciate the ranking member's reasonableness. Thank you. The Chair now recognizes Mr. Hill for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman, and thank you, Ranking Member Green, for holding this hearing.

Mr. Chairman, I am glad to have you before us. I spent a better part of my career in institutions that had you as a primary regulator, so I appreciate all the hard work and efforts on behalf of the FDIC, which really prompted more shock when I read this package, knowing for 3 decades the work of the FDIC and its staff.

I have a customer in Little Rock who sent me a note, and I just wanted you to be on the record on this question that he had. What would you say to a legally licensed and State and Federally regulated business, like a pawnbroker, who does not use money service businesses, handles all their transactions face to face, doesn't use third-party payment processors, and doesn't use the ACH system and yet still have fallen victim and had their banking relationships

cut off because of Operation Choke Point, how would you—what am I supposed to say to that business in my hometown of Little Rock?

Mr. GRUENBERG. I would encourage them to—if they were to approach an FDIC-supervised bank, we would make every effort to—assuming they are complying with the law as you indicate, that they have access to banking services.

Mr. HILL. Thank you, Mr. Chairman. On looking at the FIL-43-2013 and knowing the banking business and our responsibility to put people on a CTR list or file a suspicious activity report (SAR) if necessary, my question is, in looking at your documentation, did that go through FFIEC Act, did that particular financial institution newsletter go through the FFIEC clearance process for interagency review or was it unique to the FDIC?

Mr. GRUENBERG. The 2013 guidance was FDIC guidance. There has been a guidance relating to third-party processors that has been issued by the FFIEC as well.

Mr. HILL. But that predated the FDIC's, FIL? Was that older, that general guidance?

Mr. GRUENBERG. There was guidance prior to that, and I believe there has been guidance and an update to that as well afterward also.

Mr. HILL. And in those other agencies, did they name these same listed businesses in the same methodology that the FDIC did in your 2013 release?

Mr. GRUENBERG. The previous guidance issued by the FFIEC did also cite examples

Mr. HILL. But was it as inclusive and comprehensive a list as yours?

Mr. GRUENBERG. Just to be clear, in the financial institution letter issued in September of 2013, you could look at FFIEC guidance from September—from 2010 that was roughly comparable. The Supervisory Insights Journal article list was lengthier than a guidance that had been otherwise issued.

Mr. HILL. And this issue of reputational risk, which is something that examiners talk to their banks about as a part of the normal CAMELS process, maybe as a part of the management rating in the CAMELS review, really, aren't banks responsible for their reputation, and therefore, they ought to do business with any legally organized business in their market that needs depository services, setting aside even the credit issue for a moment?

Mr. GRUENBERG. And we have made clear in the guidance we have issued, and that guidance is public, that reputation alone is not the basis for a bank discontinuing a relationship with a customer.

Mr. HILL. But yet that is what so many of these stories that have percolated back through Congress, and I am just—I find it as a former community banker and now a Member of Congress and a former Treasury official who oversaw the regulatory process during the Bush 41 Administration, I find it stunning that that can go through a financial institution's exam council review and survive that list of businesses.

I just don't see how it happened, and I agree, Mr. Chairman, that someone who is responsible for that really needs to stand up and

take that responsibility. I appreciate you being here and responding to the committee's inquiries.

Can you think of an example in the FDIC, switching topics, where the FDIC engages in price regulation or the Comptroller of the Currency, any Federal bank regulation where they actively engage in price regulation of consumer financial transactions between banks and their customers?

Mr. GRUENBERG. Offhand, I don't believe we have authority to do that, Congressman.

Mr. HILL. So if two people have exact same credit backgrounds, exact same ages, races, borrowing backgrounds, and they live in two different cities in a State, and one has many, many job opportunities and one doesn't, do you think they deserve the same price for credit?

Mr. GRUENBERG. One would think so, assuming they have the same credit profile.

Mr. HILL. My time has expired.

Chairman DUFFY. The gentleman's time has expired. The Chair now recognizes for the last 5 minutes, the gentleman from Texas, Mr. Green, and I appreciate his cooperation and help in navigating Members as they come in.

Mr. GREEN. Thank you, Mr. Chairman. Chairman Gruenberg, you now understand that no mistake will go unnoticed and no good deed will go unpunished. Let's talk about this for just a moment, in these last 5 minutes.

You have requested an IG investigation. Is that abnormal? Is that something that you would do when you find that there is something that is questionable, to get an independent third party to come in and give a report?

Mr. GRUENBERG. No, that is not routine, Congressman.

Mr. GREEN. And you did this for a reason. Why did you do it?

Mr. GRUENBERG. We thought the allegations made were very serious, and both myself and the other internal Members of our Board felt it was important to get the facts, before making a judgment, in regard to conduct by an employee of potentially this consequence, that we wanted an independent review and the facts gathered by our Inspector General before reaching a judgment.

Mr. GREEN. You are not especially trained in this area of investigation, I assume. You are a fine public servant, but you don't perform investigations yourself. You would use the expertise of those who do this, and quite frankly, that the Federal Government has charged with the responsibility of accomplishing these ends. Is that a fair statement?

Mr. GRUENBERG. Yes, Congressman, and I would note that the initial request for the IG investigation was made by Members of Congress, and then when we received the report of the House Oversight Committee, we—I supplemented that request by asking the IG to look specifically at individuals identified in the report.

Mr. GREEN. And when you receive this report, is it your intention to take corrective action?

Mr. GRUENBERG. Based on the facts that are presented.

Mr. GREEN. I understand. And you have done many things in the interim to make sure that people understand what the policy was and is. The policy has not changed. You have had some people who

may not have followed it to the letter, but the policy hasn't changed; is that a fair statement?

Mr. GRUENBERG. Yes, the policy has been consistent.

Mr. GREEN. And you had some—

Mr. GRUENBERG. And I will say, I believe the policy has been consistent, and that is one of the things the Inspector General will be reviewing as well

Mr. GREEN. You had some people who have not adhered to the policy, the spirit and letter of the policy, but do you consider this a culture across the entire FDIC, or is this something that you are addressing as it relates to individuals?

Mr. GRUENBERG. I don't believe it is what you have described. I think one of the things the Inspector General review will try to determine is the conduct of the agency over time and was the application of the policy generally consistent.

Mr. GREEN. In your years at the FDIC, have you always encouraged and required that the policies be followed?

Mr. GRUENBERG. Yes, Congressman.

Mr. GREEN. And is this consistent with what you are doing now?

Mr. GRUENBERG. I believe so.

Mr. GREEN. And, do you believe that the FDIC should be charged with having produced Operation Choke Point? Is this something that the DOJ initiated, that was brought to the FDIC? I just want to make it clear that this is not something you initiated, the Operation Choke Point. You are concerned about fraud, and you are concerned about third-party processes, but this whole operation is not something that you produced?

Mr. GRUENBERG. No. It was a Justice Department program.

Mr. GREEN. And the Justice Department, in my opinion, has good reason to look into fraud as is the case with the FDIC, but mistakes have been made. You have done what you can to correct them immediately. You are allowing a certain amount of due process before taking your final actions. This is not unusual in our circles to be thorough, investigate totally, completely, and then make decisions. Is there any final thing that you would like to say in terms of what you are hoping to accomplish?

Mr. GRUENBERG. No. I agree with the points you have made, Congressman. We have tried to take a deliberate and balanced approach to this to address the issues in an effective way, and we are very committed to following through.

I think the basic premise that businesses that are complying with the law should have access to banking services is a sound premise and an important one. We are committed to ensuring that we conduct our supervisory activities to achieve that outcome.

Mr. GREEN. Thank you, Chairman Gruenberg, and thank you also, Chairman Duffy. I yield back.

Chairman DUFFY. Thank you. The ranking member yields back. I would like to thank our witness again for testifying today in front of our subcommittee.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection,

Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And without objection, this hearing is now adjourned.

[Whereupon, at 4:25 p.m., the hearing was adjourned.]

# A P P E N D I X

March 24, 2015

**STATEMENT OF**

**MARTIN J. GRUENBERG**
**CHAIRMAN**
**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

**THE FEDERAL DEPOSIT INSURANCE CORPORATION'S**
**ROLE IN OPERATION CHOKE POINT**

**before the**

**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**
**FINANCIAL SERVICES COMMITTEE**
**U.S. HOUSE OF REPRESENTATIVES**

**March 24, 2015**

Chairman Duffy, Ranking Member Green and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on the FDIC's supervisory approach regarding insured institutions providing banking services to customers, including third-party payment processors (TPPPs). We are aware of concerns regarding the FDIC's efforts in this area and we welcome the opportunity today to clarify the FDIC's supervisory approach. I also will discuss the FDIC's interaction with the Department of Justice's (DOJ) Operation Choke Point.

As the primary federal regulator of state-chartered financial institutions that are not members of the Federal Reserve System, the FDIC supervises these institutions for adherence with safety and soundness standards, information technology requirements, Bank Secrecy Act and other anti-money laundering laws and regulations, and consumer protection laws.

The USA PATRIOT Act, enacted in 2001, added new due diligence requirements for banks under the Bank Secrecy Act (BSA). Section 326 of the Act requires banks to establish and maintain a Customer Identification Program (CIP). At a minimum, financial institutions must implement reasonable procedures for: (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. The purpose of the CIP is to enable banks to form a reasonable belief that they know the true identity of each customer. In its most basic form, knowing one's customer serves to protect banks from

the potential liability and risk of providing financial services to a customer engaged in fraudulent and unlawful activity. In addition, but no less important, it provides another level of protection to the general public against illegal activity (including terrorist financing and money laundering), since banks are a gateway to the financial system.

Knowing your customer also involves ongoing monitoring of your customer base for signs of potential illegal activity, and when necessary, requires filing Suspicious Activity Reports (SAR) when banks believe a customer has engaged in a potential illegal activity. Regulatory guidance requires financial institutions to have a Customer Due Diligence (CDD) program that enables the institution to predict with relative certainty the types of transactions in which a customer is likely to engage. The CDD program assists the financial institution in determining when transactions are potentially suspicious, so that it can carry out suspicious activity reporting obligations. Banks, bank holding companies, and their subsidiaries are required by federal regulations, issued pursuant to the Annunzio-Wylie Money Laundering Suppression Act of 1992 to file a SAR with respect to:

- Criminal violations involving insider abuse in any amount.
- Criminal violations aggregating $5,000 or more when a suspect can be identified.
- Criminal violations aggregating $25,000 or more regardless of a potential suspect.
- Transactions conducted or attempted by, at, or through the bank (or an affiliate) and aggregating $5,000 or more, if the bank or affiliate knows, suspects, or has reason to suspect that the transaction:

- May involve potential money laundering or other illegal activity (e.g., terrorism financing).
- Is designed to evade the BSA or its implementing regulations.
- Has no business or apparent lawful purpose or is not the type of transaction that the particular customer would normally be expected to engage in, and the bank knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

TPPPs are bank customers that provide payment processing services to merchants and other business entities, and they often use their commercial bank accounts to conduct payment processing for their merchant clients. TPPPs are not subject to Bank Secrecy Act or anti-money laundering (BSA/AML) requirements, and therefore are not required to have customer identification programs, conduct customer due diligence, engage in suspicious activity monitoring, or report suspicious activity to federal authorities. As a result, some processors may be vulnerable to money laundering or other illegal transactions. It can be challenging for banks to monitor these accounts for suspicious activity, because TPPPs may have relationships with hundreds or even thousands of merchant clients for which they initiate transactions.

When a bank fails to identify and understand the nature and source of the transactions processed through an account, the risks to the bank and the likelihood of suspicious activity can increase. Accordingly, interagency regulatory guidance, which was first issued in 2005 and updated in 2010 and 2014, encourages banks offering account services to TPPPs to develop and

maintain adequate policies, procedures, and processes to address risks related to these relationships.[1]

If the bank, through its customer relationship with the TPPP, is facilitating activity that is performed in a manner illegal under applicable state or federal law, the bank can be held legally responsible. This is because, in cases where the transaction was initiated by a third party, the bank still has a relationship, albeit indirect, with the TPPP's merchant clients, and thus would be exposed to the risks associated with their transactions.

As a financial regulator, the FDIC is responsible for ensuring that the financial institutions we supervise fully understand these risks, have policies and procedures in place to identify and monitor these risks, and take reasonable measures to manage and address these risks. Accordingly, our supervisory approach focuses on assessing whether financial institutions are adequately overseeing activities and transactions they process and appropriately managing and mitigating related risks. Our supervisory efforts to communicate these risks to banks are intended to ensure that institutions perform the due diligence, underwriting and ongoing monitoring necessary to mitigate the risks to their institutions.

Traditionally, TPPPs contracted primarily with U.S. retailers that had physical locations in the United States to help collect monies owed by customers on the retailers' transactions. These merchant transactions primarily included credit card payments, but also covered

[1] See interagency guidance on examination procedures for Third Party Payment Processors, FFIEC BSA/AML Examination Manual, December 2, 2014. http://www.ffiec.gov/bsa_aml_infobase/pages_manual/olm_063.htm, originally issued June 30, 2005 and updated April 29, 2010.

automated clearing house (ACH) transactions and remotely created checks (RCCs). Guidance for FDIC-supervised institutions conducting business with TPPPs was issued as early as 1993 through interagency and FDIC examination manuals and guidance related to credit card examinations, retail payment systems operations, and the Bank Secrecy Act.[2] However, as the financial services market has become more complex and problems were identified, the individual federal banking agencies, the Federal Financial Institutions Examination Council (FFIEC) and the Financial Crimes Enforcement Network (FinCEN) have issued additional guidance on TPPPs on several occasions informing financial institutions of emerging risks and suggesting mitigation techniques.

In December 2007, the Federal Trade Commission and seven state attorneys general initiated lawsuits against payment processors who processed more than $200 million in debits to consumers' bank accounts on behalf of fraudulent telemarketers and Internet-based merchants.[3] In April 2008, an insured financial institution that provided account relationships to payment processors whose merchant clients experienced high rates of return for unauthorized transactions or customer complaints of failure to receive adequate consideration in the transaction was fined a $10 million civil money penalty by its regulator. The penalty documents note that the institution failed to conduct suitable due diligence even though it had reason to know that the payment

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[2] See Federal Reserve, SR-93-64 (FIS), Interagency Advisory, Credit Card-Related Merchant Activities http://www.federalreserve.gov/boarddocs/srletters/1993/SR9364.HTM, November 18, 1993; FDIC Credit Card Activities Manual, http://www.fdic.gov/regulations/examinations/credit_card/index.html, June 12, 2007; FFIEC Retail Payment Systems Handbook, http://ithandbook.ffiec.gov/it-booklets/retail-payment-systems.aspx, February 25, 2010, (update to March, 2004 release);and Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering InfoBase, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm, December 2, 2014 (most recent update to original June 30, 2005 and updated April 29, 2010 releases).

[3] See FTC Press Release, December 11, 2007, *FTC and Seven States Sue Payment Processor that Allegedly Took Millions form Consumers Bank Accounts on Behalf of Fraudulent Telemarketers and Internet-based Merchants.*

processors were customers that posed significant risk to the institution.[4] The Office of the Comptroller of the Currency and the FDIC subsequently issued guidance that described the risks associated with TPPPs processing ACH and RCC for higher-risk merchants.[5] In 2010, the FFIEC updated the Retail Payment Systems Handbook to provide expanded guidance on merchant card processing, ACH and RCC transactions, and the Bank Secrecy Act/Anti-Money Laundering InfoBase to provide expanded guidance on banks' accounts with third party payment processors. The updates provided a more in-depth discussion of the management challenges posed by these activities and some of the risk management tools that financial institutions can use to mitigate them and continue to provide banking services.[6]

In late 2010 and through 2011, the FDIC observed instances of TPPPs targeting small, troubled banks to enter into business relationships in return for high fees. In certain cases where the banks lacked adequate controls to manage the relationship, banks were implicated in fraudulent activity.[7] This led the FDIC to issue an informational article to raise awareness of

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[4] See United States of America, Department of the Treasury, Comptroller of the Currency, AA-EC-08-13, In the Matter of: Wachovia Bank, National Association, Charlotte, North Carolina, Consent Order for a Civil Money Penalty.

[5] FDIC Financial Institution Letter, FIL-44-2008, *Guidance for Managing Third-Party Risk*, issued June 2008; FDIC Financial Institution Letter, FIL-127-2008, *Guidance on Payment Processor Relationships*, issued November 2008; and OCC Bulletin 2008-12, *Payment Processors - Risk Management Guidance*, http://www.occ.gov/news-issuances/bulletins/2008/bulletin-2008-12.html, issued April 24, 2008.

[6] FFIEC, Retail Payment Systems Booklet, http://www.ffiec.gov/press/pr022510.htm; and Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering InfoBase, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm, December 2, 2014 (most recent update to original June 30, 2005 and updated April 29, 2010 releases).

[7] See Consent Agreement between the FDIC and SunFirst Bank, St. George, Utah, dated November 9, 2010 (FDIC-I0-845b); Notice of Assessment issued by the FDIC in the matter of First Bank of Delaware, Wilmington, Delaware, dated November 16, 2012 (FDIC-12-306k); FTC Press Release, FTC Charges Massive Internet Enterprise with Scamming Consumers Out of Millions Billing Month-After-Month for Products and Services They Never Ordered, http://www.ftc.gov/news-events/press-releases/2010/12/ftc-charges-massive-internet-enterprise-scamming-consumers-out, December 22, 2010; FTC Press Release, FTC Action Bans Payment Processor from Using a Novel Payment Method to Debit Accounts, http://www.ftc.gov/news-events/press-releases/2012/01/ftc-action-bans-payment-processor-using-novel-payment-method, January 5, 2012; FTC Press Release, Defendants Banned from Payment Processing, Will Pay $950,000 in FTC Settlement, http://www.ftc.gov/news-events/press-releases/2013/03/defendants-banned-payment-processing-will-pay-950000-ftc, March 13, 2013.

these risks in the Summer 2011 issue of the FDIC's *Supervisory Insights Journal*[8] and to issue expanded guidance on this topic in January 2012.[9] In late 2012, FinCEN issued an Advisory noting that "[l]aw enforcement has reported to FinCEN that recent increases in certain criminal activity had demonstrated that Payment Processors presented a risk to the payment system by making it vulnerable to money laundering, identity theft, fraud schemes and illicit transactions."[10]

The article and guidance were intended to describe the risks associated with financial institutions' relationships with TPPPs, and to provide guidance to insured institutions on appropriate risk management for relationships with TPPPs. Consistent with prior interagency and individual agency guidance first issued in 2005,[11] and in consideration of the rapid growth in ACH activity,[12] both documents contained examples of merchant categories that had been associated by the payments industry with higher-risk activity.[13] These examples were intended

[8] FDIC Supervisory Insights Journal, *Managing Risks in Third-Party Payment Processor Relationships*, Vol. 8, Issue 1. Summer 2011.
[9] FDIC Financial Institution Letter, FIL-3-2012, *Payment Processor Relationships, Revised Guidance*, issued January 2012
[10] Department of the Treasury FinCEN Advisory, FIN-2012-A010, *Risk Associated with Third-Party Payment Processors*, issued October 2012.
[11] See Federal Reserve, SR-93-64 (FIS), *Interagency Advisory, Credit Card-Related Merchant Activities*, http://www.federalreserve.gov/boarddocs/srletters/1993/SR9364.HTM, November 18, 1993; OCC Bulletin 2006-39, *Automated Clearing House Activities - Risk Management Guidance*, http://www.occ.gov/news-issuances/bulletins/2006/bulletin-2006-39.html, issued September 1, 2006; Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering InfoBase, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm, December 2, 2014 (most recent update to original June 30, 2005 release); FDIC Credit Card Activities Manual, http://www.fdic.gov/regulations/examinations/credit_card/index.html, June 12, 2007; FDIC Financial Institution Letter, FIL-44-2008, *Guidance for Managing Third-Party Risk*, issued June 2008; and FDIC Financial Institution Letter, FIL-127-2008, *Guidance on Payment Processor Relationships*, issued November 2008; OCC Bulletin 2008-12, *Payment Processors - Risk Management Guidance*, http://www.occ.gov/news-issuances/bulletins/2008/bulletin-2008-12.html, issued April 24, 2008.
[12] According to NACHA, https://www.nacha.org/ach-network/timeline, 7.53 billion ACH transactions were processed in 2003; 14.96 billion were processed in 2008 and 16.079 billion transactions were processed in 2011.
[13] https://www.paypal.com/us/webapps/mpp/ua/acceptableuse-full
https://payments.amazon.com/help/Amazon-Simple-Pay/User-Agreement-Policies/Acceptable-Use-Policy
https://support.google.com/wallet/business/answer/75724

to illustrate trends identified by the payments industry and were not the primary purpose of the guidance, which was to describe the risks associated with financial institutions' relationships with TPPPs and how to manage that risk. Nonetheless, including these examples led to misunderstandings regarding the FDIC's supervisory approach to institutions' relationships with TPPPs, resulting in the misperception that some deposit accounts or banking relationships with specific categories of merchants were prohibited or discouraged.

Separately, in recent years, FDIC-insured banks have heard from a number of state and federal agencies regarding the importance of ensuring that banks are properly managing their relationships with certain customers and third party payment processors. A number of states have expressed concerns about banks facilitating activities, especially online, that are illegal in their states.[14] At the federal level, DOJ also has actively contacted banks about similar issues. When the concerns and actions have involved FDIC-supervised institutions, the FDIC has cooperated with law enforcement and state regulators.

In August 2013, I received a letter from Members of Congress expressing concerns that DOJ and the FDIC were pressuring banks and third party payment processors to terminate business relationships with lawful lenders. Upon inquiring, FDIC staff informed me that, in early 2013, staff at the FDIC became aware that DOJ was conducting an investigation into the use of banks and third party payment processors to facilitate illegal and fraudulent activities. As understood by the FDIC, DOJ's efforts, which DOJ referred to as Operation Choke Point, were aimed at addressing illegal activity being processed through banks. To the extent that the DOJ's

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https://www.nacha.org/news/use-ach-network-illegal-internet-transactions
https://www.nacha.org/news/telephone-initiated-tel-entries

[14] For example, http://www.dfs.ny.gov/about/press2013/pr130806-link1.pdf.

actions were directed at illegal activity involving banks supervised by the FDIC, the FDIC has a responsibility to consider the legality of the activities as well as any potential risks such activities could pose for those institutions.

The FDIC frequently coordinates with other agencies -- both federal and state -- in its supervision of its regulated institutions. Staff informed me that FDIC attorneys communicated and cooperated with DOJ staff involved in these investigations based on an interest in any illegal activity that may involve FDIC-supervised institutions. As staff explained, FDIC attorneys' communication and cooperation with DOJ included responses to requests for information about the institutions under 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.

In order to address any concerns or confusion that existed about the FDIC's supervisory approach, we have undertaken a number of actions.

First, the agency issued a Financial Institution Letter in September of 2013 that clarified and reminded FDIC employees and financial institutions of the FDIC's policy and supervisory approach.[15] This guidance states that financial institutions that properly manage relationships and effectively mitigate risks are neither prohibited nor discouraged from providing payment processing services to customers, regardless of the customers' business, provided the customers are operating in compliance with applicable state and federal law.

[15] Financial Institution Letter, FIL-43-2013, *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*, issued September 2013.

Second, in July 2014, the FDIC took additional action to address continuing concerns about the inclusion in the article and guidance of examples of merchant categories that had been associated by the payments industry with higher-risk activity. As was discussed above, the examples of merchant categories in the FDIC's article and guidance were intended to be illustrative of trends identified by the payments industry at the time the guidance and article were released. However, the list of examples of merchant categories led to misunderstandings regarding the FDIC's supervisory approach to institutions' relationships with TPPPs, resulting in the misperception that the listed examples were prohibited or discouraged. To address these concerns, the FDIC issued a Financial Institution Letter restating its policy that insured institutions that properly manage customer relationships are neither prohibited nor discouraged from providing services to customers operating in compliance with applicable federal and state law. As part of clarifying the guidance, the FDIC removed the list of examples of merchant categories from outstanding guidance and the article.

In January 2015, the FDIC took additional actions to ensure that FDIC-supervised banks and bank supervision examiners and managers fully understand the FDIC's policies and expectations. We also established procedures to make certain that these policies and expectations are effectively implemented. These actions include the following:

- The FDIC issued a Memorandum to all supervision staff establishing new documentation and reporting procedures where the FDIC directs a financial institution to terminate deposit account relationships. The Memorandum makes explicit that the FDIC does not make business decisions, such as customer selection, for financial institutions and that insured depository institutions may provide financial services to any customer conducting business in a lawful manner. Institutions need only perform the due diligence,

underwriting and monitoring necessary to mitigate any risks that may be inherent in the relationship.

Under the new procedures, examiner recommendations for terminating deposit accounts can be made only in writing and must be approved in writing by the Regional Director before being provided to and discussed with an institution's management and board. Staff were directed that recommendations should not be made through informal suggestions. In addition, criticisms of an insured depository institution's management or mitigation of risk associated with deposit accounts that do not rise to the level of a recommendation or requirement for termination of accounts should also not be made through informal suggestions. The examiner recommendation must include the supervisory basis for why the termination is being recommended or required, including any specific laws or regulations the examiner believes is being violated. In addition, recommendations for terminating deposit account relationships cannot be based solely on reputational risk to the institution.

Regional Directors are required to provide quarterly reports to the FDIC Board of Directors and the Division Directors regarding requests or orders to terminate deposit accounts, along with the basis for such action.

- The Memorandum was communicated to all FDIC examination staff. I participated in a national call with all FDIC supervision staff where I described the new documentation and reporting requirements. In that call, I made clear the expectation of compliance with these requirements. I also met personally with the FDIC's six Regional Directors to emphasize the importance of following these procedures. In addition, the requirements will be emphasized at upcoming meetings and training sessions for FDIC supervisory staff.

  The FDIC established a new, dedicated toll-free number, 800-756-8854, and dedicated email box, bankingservicesOO@fdic.gov, for the Office of the Ombudsman for institutions concerned that FDIC personnel are not following FDIC policies on providing banking services. Communications with the ombudsman are confidential. Individuals or institutions also may contact the FDIC Office of Inspector General through its website at www.fdicoig.gov by using the "Hotline" button, by phone at 1-800-964-3342, or by email at ighotline@fdic.gov. The contact information for both the FDIC Ombudsman and the Inspector General were provided to all FDIC-supervised institutions in a Financial Institution letter.

- The FDIC issued a statement to all FDIC-supervised institutions on the practice of institutions indiscriminately terminating business relationships with certain categories of customers because of the perceived supervisory risk or heightened expense of maintaining the relationships, often known as "de-risking." This statement makes clear that the FDIC encourages institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to

entire categories of customers without regard to the risks presented by an individual customer or the financial institution's ability to manage the risk.[16]

- On December 17, 2014, I sent a letter to the FDIC's Inspector General (IG) requesting an examination of the allegations of misconduct by certain current and former FDIC employees (and any other individuals who might be identified by the IG) as part of the IG's ongoing investigation into activities surrounding Operation Choke Point that was requested previously by Members of Congress. I included a copy of the staff report of the House Committee on Oversight and Government Reform with the letter. Once the IG's factual findings are received, they will be reviewed to determine the appropriateness of any administrative action regarding the individuals still employed by the FDIC.

In conclusion, the FDIC's supervisory approach focuses on assessing whether financial institutions are adequately overseeing activities and transactions they process and appropriately managing and mitigating related risks. Our supervisory efforts to communicate these risks to banks are intended to ensure institutions perform the due diligence, underwriting, and monitoring necessary to mitigate the risks to their institutions. We have taken a number of significant steps to ensure that both our examination staff and our supervised banks understand that the FDIC will not criticize, discourage or prohibit banks that have appropriate controls in place from doing business with customers who are operating consistent with federal and state law. We also have established procedures to make certain that these policies and expectations are effectively implemented. We expect these efforts to be successful and are committed to addressing this issue.

[16] *Statement on Providing Banking Services*, https://www.fdic.gov/news/news/financial/2015/fil15005.pdf.

**EFTA Statement on Operation Choke Point**

Operation Choke Point is a campaign spearheaded by the Department of Justice (DOJ) in conjunction with several federal consumer protection and banking regulatory agencies (e.g., the Federal Trade Commission (FTC) and the Federal Deposit Insurance Corporation (FDIC)) to hold acquirer financial institutions and their payment processor partners responsible for allegedly illegal acts committed by merchants and other third-party payees.

The Electronic Funds Transfer Association (EFTA) fully supports focused government investigations of activities that knowingly facilitate consumer fraud or other unlawful activities within the payments sector. However, EFTA is increasingly concerned that the government's efforts are causing unintended consequences. By targeting legal activities that are perceived by some prosecutors and regulators as undesirable, the government has extended its efforts beyond unlawful conduct, which in turn has led to denial of access to businesses and financial services providers who operate lawfully.

Operation Choke Point has come under fire from Members of Congress, financial institutions, and merchants. After several congressional hearings, some Members found that Operation Choke Point, while initially aimed at the payday lending industry, was in fact being used to apply pressure to legal industries that were deemed "unsavory" by the Government.

Reducing access for entire industry segments simply because of assumptions of high-risk activity or political unpopularity can have detrimental effects on the U.S. economy. Operation Choke Point has the potential to substantially diminish continued economic growth stemming from electronic commerce and raises legitimate questions about the effect on the broader economic recovery if lawful businesses (especially small businesses) are denied access to the payments system and mainstream financial services.

EFTA is also concerned that any costly mandates on the payments system that are imposed as a result of Operation Choke Point will likely trickle down to businesses (and ultimately, consumers) in the form of higher transaction prices, reduced services and fewer payment options. They are also unnecessary.

EFTA members are committed to protecting consumers and the payments system from merchants engaged in illegal business practices and employ vigorous due diligence, risk mitigation, fraud detection, fraud prevention and transaction monitoring standards to help protect consumers and the overall payments system from fraud and other inappropriate activities. Before payments systems participants can initiate or accept electronic payments, they are screened by acquirer financial institutions and third-party payment processors, as required by bank regulatory guidance and the rules of the payments networks. These risked-based procedures are designed to determine and appropriately size the risks an individual company may pose to the payments system. Some participants never make it past this initial screen. Additionally, the financial services industry invests heavily in sophisticated risk

management tools to monitor accounts for risks and potentially illegal activities. That said, the payments system was designed to safely and efficiently process payment transaction data and facilitate commerce, it was not intended to also function as the arbiter of what businesses are (or are not) perceived to be facilitating "public good."

In fact, after the aforementioned Congressional hearings, the FDIC reissued guidance "clarifying its supervisory approach" toward banks establishing relationships with third-party payments processors, presumably in response to criticisms of Operation Choke Point related actions and recognition of the concerns that legal industries had experienced unintended consequences resulting from Operation Choke Point. In the change announced on July 28, 2014, the FDIC sought to clarify that the list of examples provided in earlier guidance and articles was not meant to be a list of merchant types that were discouraged or disallowed by the FDIC.

Given the robust regulatory regime that governs the electronic payments industry, EFTA encourages federal policymakers and regulatory and enforcement agencies to realign their efforts to address illegal businesses practices using the existing enforcement tools. EFTA will continue to strongly support federal law enforcement efforts to identify and catch bad actors that willingly commit fraud and scam American consumers.

*The Electronic Funds Transfer Association (EFTA) is a non-profit professional association dedicated to the advancement of electronic payments and electronic commerce. EFTA's nearly 300 members include the nation's leading financial institutions, electronic payment networks, card associations, ATM owners, operators and manufacturers, transaction processors, equipment, card and software manufacturers and vendors, state governments and federal agencies. Its objective is to inform debate over the consumer, business and policy implications of new and existing payments technology. EFTA accomplishes this through public outreach to Congress, the administrative agencies, regulators, consumers and the media.*

**Statement for the Record of**

**The Electronic Transactions Association**

**Before the**

**House Committee on Financial Services**

**Subcommittee on Oversight and Investigations**

**Hearing on**

**"The Federal Deposit Insurance Corporation's Role in Operation Choke Point."**

**March 24, 2015**

Chairman Duffy, Ranking Member Green, and Members of the Subcommittee, the Electronic Transactions Association (ETA) appreciates the opportunity to submit this statement for the House Financial Services Committee's Subcommittee on Oversight and Investigations hearing on "The Federal Deposit Insurance Corporation's Role in Operation Choke Point."

ETA is an international trade association representing companies that offer electronic transaction processing products and services related to debt, credit, and prepaid cards. The purpose of ETA is to grow the payments industry by providing leadership through education, advocacy, and the exchange of information. ETA's membership spans the breadth of the payments industry, from financial institutions to transaction processors to independent sales organizations to equipment suppliers. More than 500 companies worldwide are members of ETA.

Although ETA strongly supports increased law enforcement aimed at preventing mass frauds, it has serious concerns about the Operation Choke Point approach. In ETA's view, Operation Choke Point employs the wrong legal tools, is unnecessarily confrontational, and creates serious risks to law abiding processors and merchants without producing any benefits to consumers beyond those which could be obtained with a more focused and collaborative approach.

Unfortunately, recent reports indicate that the Department of Justice (DOJ) is continuing to pursue investigations under this controversial program.[1] This development is disheartening given Congress's expressed concerns and the apparent acknowledgment by other federal regulators, such as the Federal Deposit Insurance Corporation (FDIC), that Operation Choke

[1] Alan Zibel, Operation Choke Point: Plaza Bank Becomes Third to Settle, Wall. St. J., March 12, 2015, available at http://blogs.wsj.com/moneybeat/2015/03/12/operation-choke-point-plaza-bank-becomes-third-to-settle.

Point's blunt approach has the potential for serious adverse consequences for consumers and payment companies.[2] ETA therefore encourages the DOJ (and other federal agencies involved in Operation Choke Point, including the FDIC) to pursue a more sensible policy that recognizes the strong interest the payments industry has in preventing fraud and other illegal activities, and which allows the industry to focus on enhancing its underwriting and risk management tools to safeguard the payments system from unscrupulous merchants. In this spirit, the remainder of this statement highlights the efforts of ETA members and the payments industry to combat fraud and explains why a collaborative approach between government and industry is more likely to protect consumer interests than Operation Choke Point's adversarial approach.

**Keeping Fraud Off Payment Systems**

ETA strongly supports the vigorous enforcement of existing laws and regulations to prevent fraud. Consumers in the United States choose electronic payments over cash and checks because they have zero liability for fraud, making electronic payments the safest and most reliable way to pay. As a result, payment companies are generally responsible for paying for fraud involving payment systems under Federal law and payment network rules, and thus our members have a strong interest in making sure fraudulent actors do not gain access to payment systems. With the benefit of decades of payment system expertise, ETA members have developed effective due diligence programs to prevent fraudulent actors from accessing payment systems and to terminate access for network participants that engage in fraud. These programs have helped to keep the rate of fraud on payment systems at remarkably low levels. In 2012, there was more

[2] On July 28, 2014, the FDIC issued a Financial Institution Letter (FIL-41-2014) that clarified its supervisory approach for institutions that establish account relationships with third-party payment processors. In addition, the FDIC pulled from distribution a document that included a list of industries (tobacco, payday, etc.) that purportedly required heightened regulatory scrutiny with respect to establishing payment processing merchant relationships.

than $4.6 trillion in debit, credit, and prepaid card transactions in the United States, but there was only $5.5 billion in credit card fraud. In addition, a recent survey of ETA members indicates that more than 10,000 merchants were discharged last year for fraud. These actions demonstrate the commitment of ETA members to keeping fraudulent actors off payment systems.

Despite this strong record, however, payment processors can never take the place of regulators and law enforcement in protecting consumers. Because regulators and law enforcement can issue subpoenas, conduct investigations, and have far greater resources, personnel, and legal authorities, they will always be in a better position to combat fraud. Yet, payments companies are committed to doing their part.

ETA therefore believes we must be vigilant in continuing to update our processes. The growth of internet commerce has created remarkable new opportunities for business and benefits for consumers, but unfortunately also has created new opportunities for fraud. For example, because websites can change in the blink of an eye, they can be difficult to monitor and easy for fraudsters to exploit. Hence, ETA welcomes further Federal efforts to combat fraudulent activity by unscrupulous merchants that operate on the internet.

In an effort to further strengthen payment systems, ETA published last year new industry guidelines for merchant due diligence and monitoring that provide more than 100 pages of methods and suggested best practices to detect and halt fraudulent actors. The ETA Guidelines were developed by ETA's member companies after months of discussions and sharing of techniques to prevent fraud. During this process, ETA even shared the preliminary draft

guidelines with, and sought comments from, the Federal Trade Commission (FTC), which had strongly encouraged the industry to strengthen its anti-fraud efforts. Now, ETA is actively encouraging its members and companies across the payments ecosystem to make use of the guidelines, especially smaller companies that may not have the resources to develop such advanced practices on their own.

The ETA Guidelines provide a practical and targeted approach to combating fraud on payment systems. ETA members already have a strong commitment to, and financial interest in, keeping fraudulent actors off payment systems, and the targeted nature of the ETA Guidelines gives members enhanced tools to improve the effectiveness of their practices and help ensure that law-abiding merchants do not unfairly lose access to payment systems due to overly broad anti-fraud protections.

Another benefit of the ETA Guidelines is that they provide a basis for payments companies to work cooperatively with Federal regulators and law enforcement toward the common goal of stopping fraud. ETA strongly believes that such a collaborative approach is good public policy - it encourages companies to cooperate with law enforcement by fostering an environment of open communications between government agencies and payments companies. As a result, such a cooperative approach would be more effective in protecting consumers from fraud.

**Concerns About Operation Choke Point**

Unfortunately, the DOJ and other Federal regulators have pursued a more confrontational approach to addressing fraud on payment systems. On March 20, 2013, the Financial Fraud

Enforcement Taskforce publicly announced a new initiative by its Consumer Protection Working Group (which is co-chaired by representatives from the DOJ, the FTC, and the Consumer Financial Protection Bureau) to address mass consumer frauds by holding banks and payment processors liable for the acts of certain merchants.[3] This initiative, named "Operation Choke Point" by the DOJ, aims to "close the access to the banking system that mass marketing fraudsters enjoy – effectively putting a chokehold on it."[4]

The DOJ has sought to implement Operation Choke Point by initiating investigations and civil suits under the Financial Institutions Reform, Recovery, and Enforcement Act, 12 U.S.C. § 1833a (FIRREA). Under FIRREA, the DOJ can initiate investigations and bring civil suits for alleged violations of 14 predicate criminal offenses, including wire fraud "affecting a federally-insured financial institution."[5] Several courts have recently held that FIRREA suits can be brought against not only third parties whose violations "[affect] a federally-insured financial institution," but also against a bank whose violations affect the bank.[6] This broad reading of FIRREA has given DOJ a very powerful tool because under FIRREA the statute of limitations is 10 years and cases only need to be proven by a "preponderance of the evidence," rather than the "beyond a reasonable doubt" standard required in criminal prosecution.[7] In addition, FIRREA provides for penalties of up to $5 million for each violation or, if greater, the amount of any pecuniary gain derived by the violation or of any losses inflicted on another person.[8] These

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[3] http://www.justice.gov/iso/opa/doj/speeches/2013/opa-speech-130320.html.
[4] *Id.*
[5] 12 U.S.C. § 1833a(c)(2).
[6] United States v. Bank of New York Mellon, 941 F. Supp. 2d 438 (S.D.N.Y. 2013); United States v. Countrywide Fin. Corp., 961 F. Supp. 2d 598 (S.D.N.Y. 2013); United States v. Wells Fargo Bank, N.A., 972 F. Supp. 2d 593 (S.D.N.Y. 2013).
[7] 12 U.S.C. § 1833a(f), (h).
[8] 12 U.S.C. § 1833a(b).

provisions significantly tilt the litigation playing field in favor of the DOJ and make FIRREA cases very costly for companies to defend against and risky to litigate.

It is important to note that FIRREA was not designed to address mass frauds. It was passed to reform the regulatory regime for thrifts in the wake of the S&L Crisis of the 1980s. The purpose of Section 1833a was to protect the government from financial frauds. Hence, Section 1833a provides the Federal government with enhanced authority to pursue claims against individuals for fraudulent actions that directly harm the Federal government or harm financial institutions insured by the Federal government. It is not a consumer protection statute, which is demonstrated by the fact that FIRREA penalties do not redress consumer injury, but instead get paid to the U.S. Treasury. Therefore, the use of FIRREA for consumer protection purposes is a case of the wrong tool being used for the right goal.

Although no court has yet issued a final decision in a FIRREA case involving payment processing, DOJ has recently settled several FIRREA cases involving payment processing and issued scores of subpoenas to financial institutions as part of Operation Choke Point. These settlements, combined with recently released DOJ memoranda detailing the agency's plans for Operation Choke Point, have raised concerns among ETA's members that Operation Choke Point will result in the government seeking to broaden the scope of processor liability for the acts of merchants.[9] There is also concern that Operation Choke Point will be used to impose penalties on financial institutions for processing transactions of certain categories of legal but disfavored businesses.

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[9] The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses?, U.S. House of Representatives, Committee on Oversight and Government Reform, Staff Report (May 29, 2014), Appendix 1.

The problems with Operation Choke Point are not limited to the DOJ. ETA is also concerned that other Federal regulators, including the FDIC, appear to have followed the DOJ's lead and adopted additional initiatives modeled on Operation Choke Point. In particular, the FDIC published guidance and an informational article that contained lists of merchant categories that purportedly required heightened regulatory scrutiny for purposes of payment processing. Late last year, the FDIC issued revised guidance clarifying its supervisory approach for institutions that establish account relationships with third-party payment processors (FIL-41-2014). In doing so, the FDIC pulled from distribution the list of industries (tobacco, payday, etc.) that purportedly required heightened regulatory scrutiny. According to the FDIC, the list "led to misunderstandings" regarding its supervisory approach, including "the misperception that the listed examples of merchant categories were prohibited or discouraged." Rather, the revised FDIC guidance encourages financial institutions to implement appropriate risk management policies that focus on due diligence, underwriting, and ongoing monitoring – the same types of practices that ETA has incorporated into the ETA Guidelines. Although the FDIC's revised guidance is helpful, the key will be implementation moving forward.

There are also concerns that the FTC has begun its own Operation Choke Point.[10] Currently, the FTC can assert jurisdiction over payment processors that engage in unfair or deceptive acts or practices in violation of Section 5 of the Federal Trade Commission Act, and violations of the

[10] *Id.* (The DOJ has indicated that it is making "significant efforts to engage other agencies," including the FTC. The DOJ also has noted that "[t]he FTC's efforts in this area predate our own, and not surprisingly our agencies work closely together." (Memorandum dated November 21, 2013 to Staff of the Office of the Attorney General et. al. from Maame Ewusi-Mensah Frimpong, Deputy Assistant Attorney General, Civil Division. Subject: Operation Choke Point, p. 12)).

Telemarketing Sales Rule.[11] The FTC also can bring cases against payment processors for "assisting and facilitating" a merchant's violations of the Telemarketing Sales Rule, but such liability only applies if a payment processor "knows or consciously avoids knowing" that the merchant violated the rule.[12]

ETA fully supports the proper enforcement of these statutes by the FTC, but is concerned that the FTC is looking to change its long-standing policy of pursuing only processors that were actively engaged in assisting a merchant in committing fraud or avoiding detection. To the extent the FTC begins premising liability on nothing more than providing a merchant an account, or deems high return rates to be constructive knowledge of fraud, the FTC will dramatically alter the liability scheme for payment processing in a manner that could have significant, adverse consequences.

**Impact of Operation Choke Point on Processors, Entrepreneurs, and Consumers**

From a public policy perspective, ETA believes that the federal government should not restrict the access of law-abiding merchants to the payment systems. Operation Choke Point and any similar efforts by the FTC or other regulators to impose enhanced liability on payment processing will likely have adverse consequences for not only merchants and entrepreneurs, but also the very consumers Operation Choke Point purports to protect. In addition, Operation Choke Point sets a troubling precedent of government agencies using the payment systems to achieve objectives unrelated to preventing financial fraud.

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[11] 15 U.S.C. § 45; 16 C.F.R. § 310.
[12] 16 C.F.R. § 310.3

First, if payment companies' liability for the actions of merchants increases, processors may very well have little choice but to increase the prices of payment services for merchants and/or restrict access to payment systems to manage their new liability exposure. Invariably, the brunt of these burdens will fall on small, new, and innovative businesses because they pose the highest potential risks. For example, start-up internet businesses with liberal return policies present high risks to financial institutions because they have no transaction history, rely on card-not-present transactions, and have higher return rates. Federal regulators view high return rates as strong evidence of fraud. Due to the risks these new businesses present, banks and payment processors may very well decide that the increased liability risks outweigh the benefits of having them as customers. Because in today's marketplace consumers expect merchants to accept debit, credit, and prepaid cards, the inability of a merchant to access the payment systems could effectively be the death knell for its business. New restrictions on access to payment systems, or even higher costs to access payment systems, could therefore become an impediment to job creation and innovation, especially in the critical high-tech start-ups and internet commerce segments of the economy.

Second, increasing liability on payment processing, especially processing of debit, credit, and prepaid cards, does not necessarily benefit consumers. It is consumers who will ultimately pay for the higher costs arising from increased liability. They also will be harmed by the inconvenience of not being able to use their preferred methods of payment (credit, debit, and prepaid cards) with some merchants due to more restrictive access to payment systems. Similarly, consumers would be harmed if new liability on processors impedes continued innovation in electronic payments. Over the last twenty years, electronic transactions have

grown rapidly to become the dominant method of payment for consumer transactions due to their convenience, security (especially when compared to cash), and customer service. Therefore, to the extent that new liability risks impede the evolution of electronic transactions, consumers will have less access to the payment methods they prefer and beneficial developments in electronic payments.

Third, there is a real risk that a confrontational approach, like Operation Choke Point, will alter payments companies' natural incentive to cooperative with law enforcement and regulatory authorities if they believe that such cooperation will only result in enforcement actions against them. Thus, a far better approach would be to establish a reasonable safe harbor that would allow payments companies, which were not directly involved in the fraudulent activities of a merchant, to work with regulators without any risk of triggering an enforcement action. ETA believes that such cooperation between payments companies and regulators is likely to be more effective because it recognizes and further strengthens the strong incentives such companies already have to prevent fraudulent actors from accessing payment systems. This conclusion (as well as further analysis of the adverse consequences arising from imposing additional liability on payment processors) was also the result of a study by NERA Economic Consulting commissioned by ETA, which is attached as Exhibit A.

Finally, enforcement actions against payment systems are an inappropriate tool for regulators to use to limit the ability of consumers to access legal but currently disfavored industries. There has been much debate about Operation Choke Point and similar regulatory efforts to compel payments companies to sever relationships with a variety of legal but disfavored industries,

ranging from coin dealers and short-term lenders, to home-based charities and pharmaceutical sales.[13] ETA believes that such efforts unfairly expose institutions to regulatory actions merely for engaging in lawful commerce. Moreover, if the precedent is set that regulators can unilaterally intervene to keep certain lawful industries off payment systems, payments companies will be subject to shifting regulatory exposure as the disfavored industries of regulators shift with changes in administrations and agency personnel. If regulators have concerns about a particular industry, the appropriate ways to addressing those concerns are through formal rulemakings, Congress, or state legislatures. To be clear, ETA takes no position on which types of industries should be legal and its members are fully committed to preventing any businesses engaged in activities prohibited by statute or regulation from accessing payment systems. ETA merely seeks to ensure that payments companies can freely process transactions for any law-abiding merchant.

**Conclusion**

Operation Choke Point is premised on the flawed assumption that increasing liability on lawful payments companies for the actions of fraudulent merchants will yield only benefits to consumers. In practice, however, imposing new liability standards on such institutions is likely to have serious adverse consequences for not only law-abiding merchants, but also consumers generally. There needs to be a careful balancing of the need to limit access to payment systems to prevent fraud and the need to ensure that all law-abiding businesses can access the payment systems. A cooperative approach to combating fraud by financial institutions and Federal regulators is far more likely to strike the right balance than blunt enforcement actions.

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[13] *See* The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses?, U.S. House of Representatives, Committee on Oversight and Government Reform, Staff Report (May 29, 2014), p. 8.

Accordingly, ETA stands ready to work with federal regulators to work cooperatively toward our common goal of preventing fraud.

**Response to questions from the Honorable Blaine Luetkemeyer**
**By Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: Have you had any communication with the FDIC Board of Directors on Operation Choke Point? Do you have any reason to believe that the FDIC Board of Directors had knowledge of Operation Choke Point before August 2014?**

A1: As I indicated in my March 24, 2015 statement before the Subcommittee on Oversight and Investigations, I first learned of this issue when I received a letter from Members of Congress in August 2013 expressing concern that the Department of Justice (DOJ) and the FDIC were pressuring banks and third-party payment processors to terminate business relationships with lawful lenders. As you know, Vice Chairman Hoenig and FDIC staff met with you and Rep. Yoder in September 2013 to discuss this issue. I am not aware that any FDIC Board Members had knowledge of Operation Choke Point before August 2013.

Since August 2013, I have had occasional conversations with various FDIC Board members regarding allegations about the FDIC's involvement. For example, I have worked with Vice Chairman Hoenig to address concerns expressed by you and other Members and to develop responsive FDIC guidance and procedures. Issues regarding Operation Choke Point have not been subjects of discussion at any FDIC Board meetings.

**Q2: During your testimony, you indicated that, since publication of the January FIL, the FDIC Ombudsman has received fifteen complaints related to Operation Choke Point. When did the incidents detailed in those complaints occur?**

**A2:** On January 28, 2015, the FDIC issued a FIL titled *Statement on Providing Banking Services* (Statement).[2] This FIL encourages institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers. Since the statement's issuance, the FDIC's Office of the Ombudsman (Ombudsman) received 15 inquiries. Of these 15 inquiries, ten were not related to the statement or the FDIC, including instances of email spam. The Ombudsman was unable to determine the nature of two of the inquiries after repeated attempts to contact and discuss the matter with the callers.

The remaining three inquiries were in response to the statement. Two of these inquiries described in Answer 2a below addressed incidents that occurred before January 28, 2015. The third inquiry was an attempt to reach the FDIC's OIG and not the Ombudsman.

[2] Available at https://www.fdic.gov/news/news/financial/2015/fil15005.html.

Since the hearing, the FDIC Ombudsman has not received any additional contacts through the dedicated email address or by phone. However, the FDIC has followed up on three other instances of concerns expressed by individuals. These instances were as follows:

- The Ombudsman routinely follows up with institutions that change their charter to discuss the reasons for the change. In one instance, an individual at the bank stated that the bank changed its charter because FDIC examiners told the bank to close the accounts of third party payment processors. In following up on the comment, it was determined that the bank was last visited by the FDIC in December 2013 to review its Automated Clearing House third party payment processor activities. Upon review, there were no indications that the FDIC directed the bank to exit third party payment processor relationships. In fact, the FDIC's letter transmitting the visitation findings stated that "the management team is sufficiently experienced and competent to oversee the program and to initiate necessary changes to mitigate increased risks that have become apparent." In addition, an October 2014 note to the file prepared by the case manager regarding a recent contact with the banker stated that the banker "...thought the FDIC was a little heavy handed regarding the banks involvement in third party payment processing, but further noted that the suggestions by the field examiners at the most recent visitation to review the activity were good."

- In a conversation with the Ombudsman earlier this year, a banker stated that examiners directed him to exit relationships with marijuana businesses. Upon review, it was determined that the bank was advised by a state regulator that it could not operate its marijuana-related business line in that state because it had not filed the proper application. The bank's board of directors subsequently made the decision to exit all of its relationships with marijuana-related businesses. Letters and emails from the banker confirm that the FDIC did not direct the bank to exit the business line.

- In April 2015, the FDIC's Office of Minority and Women Inclusion was contacted by representatives of unnamed tribes seeking assistance for tribal governments that were having difficulty accessing banking services or that had their accounts closed. Upon review, it was determined that the banks involved were not supervised by the FDIC.

**Q2a: If the incidents occurred before issuance of the FDIC's January guidance, what follow-up work has FDIC done?**

**A2a:** The Ombudsman contacted the two callers who responded to the FIL to express concerns regarding the FDIC and the FIL. Both individuals said they worked for a financial institution. In the first case, the individual generally described an interaction with FDIC staff years earlier. However, the individual specifically did not request any additional action and did not provide sufficient detail to permit the FDIC to follow up. In the other case, a bank president contacted the Ombudsman to ask whether his loan policy was consistent with the FDIC's January guidance and provided a copy. After consulting with bank supervision staff, the Ombudsman followed up with the individual in writing confirming that his institution's loan policy was consistent with the guidance.

**Q2b: If the incidents occurred after issuance of the FDIC's January guidance, what actions has FDIC leadership taken against examiners for failure to follow FDIC policy? Provide the dates of any disciplinary action.**

**A2b:** No further action was needed as the incidents occurred before January 28, 2015.

**Response to questions from the Honorable Mick Mulvaney**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**To date, there have been no reports of banks re-establishing relationships with companies on your "high risk" list who have been affected by the FDIC's program to identify and target legal businesses for increased scrutiny with the goal of eliminating them, commonly known as "Operation Choke Point." In fact, legal, legitimate, state-licensed businesses are continuing to lose long-established banking relationships despite your assertions that the FDIC has stopped this policy. I also have no information about what the FDIC is doing to remedy the harm that has been caused to banks, the legal businesses they serve, and their consumers. I understand you say you've made some changes to stop the program, but I don't see what you are doing to make up for the impact this policy has had.**

**Q1: To that end, Chairman Gruenberg, what have you and the FDIC done to encourage banks to lend to the list of businesses on the "high risk" list, many of whom have lost their banking services?**

**Q2: In 2008, the FDIC established a case study, called the Small Dollar Loan Pilot Program, which used $40 million of FDIC funds and 28 volunteer banks to try to demonstrate that payday lending wasn't needed and traditional banks could fill this market.**

**Have you considered establishing a similar case study program to reverse the effects of your policies, and to encourage banks who are willing to provide credit and banking services to legal businesses, particularly those whose banking relationships were severed as a result of the FDIC's participation in Operation Choke Point? If not, why not?**

**Q3: What will you commit to doing today to encourage banks to lend to the list of businesses on the "high risk" list that have been affected by your policies? Please provide this Committee, in writing, the steps the FDIC specifically proposes to take to encourage banks to reestablish credit and banking service relationships with these businesses and the timeline for implementing those steps.**

**A1-3:** As I outlined in my statement before the Subcommittee on Oversight and Investigations on March 24, 2015, the FDIC has taken a number of steps to encourage insured financial institutions to serve their communities and to clarify that institutions that appropriately manage their customer relationships are neither prohibited nor discouraged from providing banking services to customers operating in compliance with state and federal laws. These steps include:

- On January 28, 2015, the FDIC issued a *Statement on Providing Banking Services.*[1] This statement encourages institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories

[1] Refer to https://www.fdic.gov/news/news/financial/2015/fil15005.html.

of customers without regard to the risks presented by an individual customer or the bank's ability to manage the risk. The statement emphasizes that financial institutions that can properly manage customer relationships and effectively mitigate risks are neither prohibited nor discouraged from providing services to any category of customer accounts or individual customers operating in compliance with applicable state and federal laws.

- On July 28, 2014, the FDIC issued a Financial Institution Letter entitled, *FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors* (FIL-41-2014) to clarify and reinforce the FDIC's policy and supervisory approach. The FDIC also removed lists of examples of merchant categories from its official guidance and an informational article to eliminate any misperception that the FDIC prohibits or discourages institutions from providing financial services to certain industries.

- In September 2013, the FDIC issued a Financial Institution Letter that clarified and reminded financial institutions of the FDIC's policy and supervisory approach. Financial Institution Letter, FIL-43-2013, *FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities*, stated that financial institutions that properly manage relationships and effectively mitigate risks are neither prohibited nor discouraged from providing payment processing services to customers, regardless of the customers' business models, provided they are operating in compliance with applicable state and federal law.

Finally, with regard to the suggestion of establishing a pilot program, the Small Dollar Loan Pilot Program was a case study designed to illustrate how banks can profitably offer small dollar loans. The program resulted in a template of product design and delivery elements for safe, affordable and feasible small dollar loans. No FDIC funds were used and banks participated voluntarily. In the guidance described above, the FDIC has similarly provided direction to banks to provide banking services to all businesses.

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