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Is Operation Choke Point to blame for bank account closures?

By Lauren Saunders

Pawn brokers, payday lenders, gun dealers, and others claim that the Department of Justice's Operation Choke Point and bank regulator pressure are forcing banks and credit unions to close the accounts of legal businesses. But most of those account closures have more to do with the Bush Administration's 2001 USA Patriot Act than with Operation Choke Point. Banks also close accounts all the time for a variety of other reasons.

Complaints about bank account closures and "de-risking" go back a decade, to implementation of the post-9/11 reforms to deny criminals access to the banking system.

The National Pawnbroker Association is now blaming Operation Choke Point. But in 2006, pawnbrokers were complaining to the Financial Crimes Enforcement Network (FinCEN) about the Patriot Act and related anti-money laundering efforts: "Pawn industry members have lost longstanding lines of credit as well as demand deposit relationships in most parts of the country since 2004."

FiSCA, the trade association representing many check cashers, money transmitters, and payday lenders, had the same complaint in 2006: "For the past six years banks have been abandoning us - first in a trickle, then continuously accelerating so that now few banks are willing to service us …."

Unfortunately, scrutiny of cash deposits, international transactions, and know-your-customer rules are more important now than ever. Yes, accounts with high levels of cash or international remittances – including accounts of legal payday lenders and gun dealers – can be impacted. If regulators find that a financial institution does not have appropriate controls, it may require certain accounts to be closed until those controls can be put in place. Banks may close accounts if they cannot confirm the ownership or legal business purpose for the account. Some financial institutions will also make their own business decision to simplify compliance by staying out of certain areas.

Apart from money laundering compliance issues, banks close accounts for a variety of other reasons that have nothing to do with regulators' disapproval of the customer's line of business. Banks respect their customers' privacy and may be unwilling to talk publicly about why an account was closed, but the bank could have seen signs of suspicious activity or account mismanagement. Banks may also decide to exit unprofitable areas or to close accounts for other reasons. A few anecdotes drawn from the thousands of accounts that are closed every year do not prove a pattern.

But Operation Choke Point does deserve credit for account closures in one area -- accounts that are being used for domestic scams. The Department of Justice has sent a clear signal: banks that willfully ignore blatant signs of fraudulent or other illegal activity will be held accountable. No one can defend the conduct of the banks – or criticize the Department of Justice's enforcement actions – in the three Choke Point cases to date. All three actions involved banks that ignored numerous complaints from consumers, government officials, and other banks and had high rates of payments challenged as unauthorized. These banks facilitated scams against seniors as well as telemarketing fraud, illegal and fraudulent online payday lending, and a Ponzi scheme.

The publicity over these three cases and bank regulator warnings about payment fraud have appropriately led financial institutions to shut down some accounts involved with illegal or fraudulent activity. Third party payment processor accounts, in particular, are often essential for scam operations. When a bank closes the account of a payment processor, the legal clients of that processor may also be affected, but legitimate businesses can find a new processor.

Online payday lenders that operate unlawfully without state licenses have also felt the heat. Contrary to their claims, affiliation with an Indian tribe does not exempt a lender from state laws. The U.S. Supreme Court made clear last year that states may require licenses and legal compliance when tribes operate off-reservation. Banks may close the accounts of lenders that cannot show state licenses or that generate complaints about fraudulent activity and unauthorized withdrawals, which are rampant in online payday lending. And some banks may choose to stay away from payday lending, which is illegal in many states.

Financial institutions appropriately close bank accounts for many reasons. We should not draw broad, unsubstantiated conclusions from a few anecdotes. Instead, let's thank the prosecutors, regulators, and financial institutions that are working to cut off terrorists, drug dealers, criminals, and fraudsters from the payment system.

Saunders is the associate director of the National Consumer Law Center in Washington, DC.