IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA, LTD., et al.,

Plaintiffs,

v. No. 14-953 (GK)

FEDERAL DEPOSIT INSURANCE CORPORATION, et al.,

Defendants.

AMICUS BRIEF IN SUPPORT OF PLAINTIFFS'

OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

I. Introduction

A. Interest of the *Amicus Curiae*

William M. Isaac has over 45 years of experience in the banking industry, having served as a bank regulator, bank attorney and consultant, and bank board member. Mr. Isaac is a graduate of Miami University and The Ohio State University College of Law. In 1978, President Carter appointed him, at the age of 34, the youngest ever member of the FDIC board. In 1981, President Reagan appointed him Chairman of the FDIC. In late 1985, Mr. Isaac returned to work in the private sector nearly two years beyond his six-year term at the FDIC. During his time at the FDIC, he also served as Chairman of the Financial Institutions

Examination Council (the coordinating body for the federal regulators of depository institutions), was a member of the Basel Committee and the Depository Institutions Deregulation Committee, and served on the Vice President's Task Force on Regulation of Financial Services. After leaving the FDIC, Mr. Isaac founded a financial services consulting firm. He also served as non-executive Chairman of Fifth Third Bancorp until he retired from that position in April 2014. He has published numerous articles in *The Wall Street Journal, Financial Times, Washington Post, The New York Times, Forbes,* and *American Banker*. He appears regularly on television and radio and has testified frequently before Congress on finance and regulatory matters. Mr. Isaac's extensive experience in banking both in the government and private sectors give him a unique perspective on the dangers of extra-legal government interference with lawful businesses' banking relationships.

This *amicus* brief is intended to supply this Court with background on Operation Choke Point and the non-bank or alternative financial services industry ("AFS"), including payday lenders. In *amicus*'s view the AFS, including payday lenders, serves an important function for many consumers, and the threat to its existence represented by Operation Choke Point is having serious repercussions.

B. Operation Choke Point

According to documents provided to the House Committee on Oversight and Government Reform, in 2013, some or all of the Defendants here, working with the Department of Justice and other government agencies (collectively hereinafter referred to as the "Government"), opened a broad investigation of banks and financial payment processors, which they called Operation Choke Point. *See The Department of Justice's "Operation Choke Point"" Illegally Choking Off Legitimate Businesses?*, Staff Report of the House Committee on Oversight & Gov't Reform, 113th Cong., at HOGR-3PPP000339-340 (May 29, 2014) (hereinafter "House Report"). This investigation began with subpoenas under section 951 of the Financial Institution Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which permits the Attorney General to seek civil monetary penalties from entities that commit certain types of fraud "affecting a federally insured financial institution." 12 U.S.C. § 1833a(c)(2).

While the Government claims Operation Choke Point was initially targeted at online payday lenders that lend into states prohibiting payday lending (thereby violating state laws), it has been pushed far beyond this initial objective, and internal government documents obtained by the House of Representatives suggest that the real goal from the beginning was to target entire industries deemed "high risk" or otherwise undesirable by the administration through regulatory pressure on their banks. *See id.* at HOGR-3PPP000458. The Government highlighted two-dozen types of legal businesses that it considers "high risk" or "undesirable," including ammunition dealers, adult film producers, check cashers, payday lenders, telemarketers, firearms and fireworks vendors, raffles, pharmaceutical sellers, life-time guarantees, surveillance equipment firms, and home-based charities. Federal Deposit Insurance Corporation, Financial Institution Letter, FIL-3-3012, January 31, 2012; Federal Deposit Insurance Corporation, Supervisory Insights, *Managing*

Risk in Third-Party Payment Processor Relationships (Summer 2011). Through Operation Choke Point, some regulators are now pressuring banks to close accounts with these disfavored businesses (on a sweeping, industry-wide basis) without requiring any showing of wrongdoing by the customer, or any actual risk to the banks themselves. By "choking off" their access to bank services, the Government is attempting to shut down legal businesses or drive them underground, not because of any wrongdoing, but simply because they fall within one of the disfavored categories.

II. Payday loans serve a legitimate purpose for millions of Americans.

Millions of low and middle-income Americans live paycheck to paycheck and have little to no savings or liquid assets. Even though they have steady employment, an unexpected car repair or emergency doctor's bill may put them in a temporary financial crunch. Millions of consumers lack even a checking or savings account, so for them turning to a bank for a loan is not an option. *See* Fed. Deposit Ins. Co., 2011 FDIC National Survey of Unbanked and Underbanked Households 3 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf (28.3% of all U.S. households are deemed unbanked or underbanked). Some turn to friends or family for a small loan to get them through a rough patch, while others may turn to credit cards. Still others face a Hobson's choice of deciding between having their utilities disconnected, their car repossessed, or paying bounced check fees to their bank. Payday lending offers a way out of this bind for many. Payday lender's stores are more numerous than Starbucks and McDonalds today, and an estimated 4.7% to 5.5% of U.S. households have used payday lending at least one time. Steven M. Graves, *Usury Law & the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation*, 57 Catholic L. Rev. 638, 668-70 (2008). *See also* Research data assembled by Dr. Steven M. Graves, California State University Northridge, available at http://www.csun.edu/~sg4002/research/research_home.html.

Obtaining a payday loan is relatively simple. A person with a job, a checking account, and photo identification can borrow from around $100 to $500 until his or her next payday. While the procedures differ slightly depending on the state, the borrower usually writes a post-dated check to the lender for the loan amount, plus a fee, typically around 15% of the amount borrowed. No collateral is needed (other than the post-dated check), the terms of the loan are clear, and they are the same for every borrower. Brian T. Meltzer & Donald P. Morgan, Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit 1-2 (Dec. 2, 2009) (unpublished manuscript), *available at http://www.clevelandfed.org/research/conferences/2010/9-9-2010_household-finance/index.cfm*. Payday lenders usually display product terms prominently on the walls of the storefront, and most borrowers say they understand the terms well, including how much it will cost and how long it will take to repay. *Payday Loans and the Borrower Experience*, Harris Interactive, p.5, 12 (December 2013), available at http://cfsaa.com/Portals/0/Harris_Interactive/CFSA_HarrisPoll_SurveyResults.pdf Once the borrower's payday arrives, he or she can either return to the lender and repay the loan in person, or the lender can cash the check or initiate an electronic funds transfer. In some states, the borrower can ask for an extended repayment period or another smaller loan. The whole process usually takes about 15 minutes for a first time borrower

Payday lending critics point out that the interest rates are high. For instance, a $15 charge for a two week loan of $100 amounts to a 391% annual percentage rate. While that is high when expressed as an annual rate, the typical term for a payday loan is only about two weeks, so the borrower only pays $15. It is easy for a consumer to compare the cost of a payday loan to the alternatives—losing a job due to lack of transportation because a car needs repair, losing electricity, losing heat during the winter or air conditioning during the summer, being assessed late fees on rent or credit card payments, losing telephone service, or incurring overdraft charges on a checking account. *Borrower Experience* at 7, 9. As expressed in APR terms, a $29 overdraft protection charge on a $100 check for two weeks is 755%; a $37 late fee on a $100 credit card bill is 965%; and a $56 bounced check fee from a merchant on a $100 check amounts to an APR of 1449%. *Payday Advance: A Cost Comparison of the Alternatives*, available at http://cfsaa.com/our-resources/policymaker-resources/payday-advance-a-cost-comparison.aspx. And, as already noted, consumers for whom payday lending is a viable option usually do not have access to more traditional forms of lending. Many payday borrowers do not have a credit card due to low credit score or lack of credit history. Payday lenders are generally the only unsecured lenders that make short term loans without regard to credit history.

In short, the payday lending industry offers a product that millions of consumers need, as shown by their actions in the marketplace. Moreover, when the Consumer Financial Protection Bureau ("CFPB") held a field hearing on payday lending, the overwhelming majority of the constituents who came to testify related positive experiences with payday loans. *In the Matter of: A Field Hearing on Payday Lending*, January 19, 2012, available at http://files.consumerfinance.gov/f/2012_cfpb_transcript_payday-lending-field-hearing-alabama.pdf. Satisfied borrowers told stories of how payday lending had worked for them. For instance, one borrower donated a kidney to her critically ill brother, then during her recuperation took out a payday loan to tide her over until her short term disability benefits kicked in. She calculated that this two week loan saved her $210 in bank fees. *Id.* at 99. Another woman was satisfied with a small payday loan she took out to pay for her six year old's birthday party. *Id.* Another borrower said that a payday loan saved him $90 in late fees for bills when he was without a paycheck for two weeks when he started a new job with a different payroll schedule. *Id.* at 101-02. Another testified that she took out a payday loan for a family emergency because it was cheaper than taking a cash advance on her credit card. *Id.* at 103. A single mother with bad credit used a payday loan to purchase Christmas presents because she knew she would not qualify for a bank loan. She testified that she was satisfied with the clear terms and that she knew exactly what she was doing. *Id.* at 108-09. The payday loan industry is performing a vital function in the economy and should be regulated under the currently existing system, not driven underground where unscrupulous operators have free reign to take advantage of consumers. Moreover, recent research has shown that in states that eliminate payday loans completely through strict usury ceilings, consumers with access to credit cards substitute revolving credit for payday loans, while unbanked consumers turn to pawnshops for loans or even outright sale of their personal posessions. Anna Ellison & Robert Forster, *The Impact of Interest Rate Ceilings*, Policis, 40 (2008) *available at* http://policis.com/publications.htm. Another study found that in states where payday loans were restricted, bounced check revenues at banks increased. Donald P. Morgan, Michael R. Strain & Ihab Seblani, *How Payday Credit Access Affects Overdrafts and Other Outcomes*, 44 J. Money, Credit & Banking 519, 519 (2012).

III. Payday lending is legal in most states and is already regulated by the CFPB and state regulators.

Since the 1980s, regulatory agencies have used a uniform rating system to assess banks. It is referred to as the CAMELS system, since it measures Capital adequacy, Asset quality, Management capabilities, Earnings performance, Liquidity, and Sensitivity to interest rate fluctuations. Uniform Financial Institutions Rating System, 62 Fed. Reg. 752 (Jan. 6, 1997). Banks have also been subject to the Bank Secrecy Act and the anti-money laundering statutes (BSA/AML) for decades. *See* 31 U.S.C. § 5311, et seq., 12 U.S.C. § 1786(g), 1818(s), 1829b, and 1951-59. BSA/AML began as a law intended to detect tax evasion, organized crime, and drug trafficking. Following September, 11, 2001, it was greatly expanded to include detecting flows of money related to terrorist activity. Banks are already required to know their customers well enough to detect suspicious flow of funds that could signal these illegal activities and to report these suspicious funds flows. Banks are also supposed to detect and reject transactions involving persons on government terrorist watch lists. Examiners devote a good deal of attention to ensuring that banks have proper controls in place to meet these responsibilities, and regulators regularly impose substantial penalties on banks that are lax. If a bank is knowingly participating in wire fraud or some other sort of illegal scheme with a customer, the Department of Justice can file suit in district court, as it did recently against the Four Oaks Bank & Trust Company in North Carolina. *See United States v. Four Oaks Fincorp. Inc. and Four Oaks Bank & Trust Co.*, No. 5:14-cv-00014-BK (E.D.N.C. filed Jan. 8, 2014) (alleging violations of the Anti-Fraud Injunction Act and FIRREA).

What is different about Operation Choke Point, however, is that the CAMELS factors and the BSA/AML have never imposed a duty on banks to ensure that their customers are complying with *every law in every state* or that banks' customers are treating *their* customers fairly and delivering good value. While many banks may choose not to do business with customers who are treating people unfairly or may be violating the law, that decision is best left to the management and board of directors of each bank, not unelected federal bureaucrats. By attempting to impose these additional duties on banks to monitor and be responsible to the customers of their customers, the Government has triggered a widespread trend in the banking industry labeled "de-risking." Banks throughout the country are de-risking by refusing to do business with any individuals and businesses they fear might be engaged in lawful business activities labeled by the Government as "questionable," "undesirable," or "risky". Because of regulatory pressure, the banks fear customers who have customers that they (the banks) do not fully understand, and the banks have made a judgment that terminating these relationships is a better economic choice than to invest even more heavily in due diligence and other risk controls and/or run the risk of regulatory backlash. Bank after bank is giving long-time customers engaged in lawful businesses notices that the bank is terminating the relationship and closing their deposit accounts. A crisis is building as this process is placing banking systems in countries and regions throughout the world at risk of losing their ability to do business with U.S. banks. This includes banks in some of the most underdeveloped parts of the world most in need of access to the global banking system. The same can be said for millions of working class people, unbanked or underbanked, who rely on check cashers, payday lenders, and other AFS companies to meet their financial needs.

During the Dodd-Frank debates, a proposal in Congress to place a statutory interest rate cap on payday loans was rejected. This proposal would have had the practical effect of a ban since the loans would be virtually unprofitable from a credit risk standpoint. Instead, Congress created the CFPB and gave it authority to regulate and supervise payday lending, but specifically prohibited it from imposing any usury limit on consumer loans. *See* 12 U.S.C. § 5517(o). Under Dodd-Frank, the CFPB has authority to punish any unfair, deceptive, or abusive act or practice by a seller of a consumer financial product. The CFPB considers a lending practice "abusive" if it:

> (i) Materially interferes with a consumer's ability to understand the product or service or (ii) takes unreasonable advantage of the consumer's lack of understanding, inability to protect his or her interests, or unreasonable reliance on a covered person to act in the interests of the consumer.

CFPB Supervision and Examination Manual, p. 52. So, for instance, a payday lender can violate these standards by failing to disclose fees, other material terms of the loan, or rights of the borrower.

Dodd-Frank also requires the CFPB to collect reports and examine payday lenders for purposes of ensuring compliance with federal law, obtaining information about the lender's procedures to prevent violations, and detect risks to consumers created by the payday lender's products. If during supervision, CFPB detects a violation of federal consumer financial laws, it has the power to impose significant financial penalties ranging from up to $5,000 per day that each violation continues, to $25,000 per day if a violation is reckless, and $1,000,000 per day if the violation is committed knowingly. The CFPB also has authority to bring enforcement actions in federal district court. *See Consumer Financial Protection Bureau v. Cash Call*, No. 1:13-cv-13167 (D. Mass. filed Dec. 16, 2013). See *also Consumer Financial*

Protection Bureau v. Mosely, et al., No. 4:14-cv-00789-DW (W.D. Mo. filed September 8, 2014) (alleging violations of the Consumer Financial Protection Act, Truth in Lending Act, and the Electronic Funds Transfer Act).

Payday lending has also traditionally been regulated at the state and local level through oversight, regulation, licensing, and prosecutorial enforcement, usually falling under the traditional consumer protection laws. Robert L. Clarke & Todd J. Zwicki, *Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau*, 33 Rev. of Banking & Financial Law 235, 242-43 (2013). State regulation of payday lending varies widely, from strict usury laws resulting in prohibition, to less strict regulation in others. *Id. See also*, Consumer Fin. Prot. Bureau, *CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings* 9 (2013).

IV. Operation Choke Point is extra-legally attempting to shut down legal businesses by exerting regulatory pressure on their banks.

The Government appears to prefer coercing banks to drop customers through Operation Choke Point rather than traditional litigation (prosecuting illegal or fraudulent businesses directly), because it's easier and faster and requires fewer resources. House Report, at HOGR-3PPP000339. By unduly pressuring banks to cease doing business with entire categories of legal businesses, Government can clearly do more damage with less work. Without a doubt, Operation Choke Point casts a broad net, and it has caught many law-abiding businesses along with the wrongdoers. But make no mistake, the government was well aware of that risk, and simply chose to shift the burden of dealing with it onto its innocent victims:

> Although we recognize the possibility that banks may have therefore decided to stop doing business with legitimate lenders, we do not believe that such decisions should alter our investigative plans. Solving that problem—if it exists—should be left to the legitimate lenders themselves who can, through their own dealings with banks, present sufficient information to the banks to convince them that their business model and lending operations are wholly legitimate.

Id. at HOGR-3PPP000335. So, because of Operation Choke Point, scores of legitimate, legal businesses are guilty until they prove themselves innocent, even though there is no allegation of wrongdoing that the business can even attempt to disprove. Under Operation Choke Point, many banks' customers are simply "guilty" of conducting a legal business that the Government considers "undesirable" or "high risk," therefore they lose access to the banking system without any means of appeal.

So far, Operation Choke Point has had far ranging effects, choking off numerous legitimate legal businesses from the banking system. Recently Brian Brookman, a Michigan pawn shop owner and rare coin dealer lost his business account with JP Morgan because those two activities are "high risk" according to federal regulators. Kelsey Harkness, *Meet Four Business Owners Squeezed by Operation Choke Point*, the Daily Signal, *1 (Aug. 12, 2014) *available at* http://dailysignal.com/2014/08/12/meet-four-business-owners-squeezed-by-operation-choke-point/. When Chase Bank and Horizon Community Bank canceled accounts with Steve Stratford, who owns a payment processing company that serves law firms in the debt relief industry, he set out to find out why. A risk management official at Chase confirmed his suspicion that government officials had exerted undue influence, resulting in hundreds of accounts in similar industries being closed under threat of federal audits. *Id.* at * 3. Sandra Perry, owner of the Cash Express, a business offering cash loans and car title loans, is now forced to drive 80 miles to the nearest bank because all the local banks and credit unions have told her that her business is too "high risk" for the banks. This, despite her "A+" rating from the Better Business Bureau. *Id.* at * 4.

Ironically, at the same time the Government is trying to "choke off" entire categories of legal businesses that provide legitimate services to consumers, it is encouraging banks to offer accounts to illegal marijuana dealerships.[1] *See* Financial Crimes Enforcement Network, U.S. Dep't of the Treasury, Guidance: BSA Expectations Regarding Marijuana-Related Businesses, Feb. 14, 2014; Memorandum from James M. Cole, Deputy Attorney General, U.S. Dep't of Justice, to All United States Attorneys: Guidance Regarding Marijuana Enforcement (Aug. 29, 2013). Regardless of whether one favors payday lending or legalized marijuana, every American should be frightened by this egregious example of unconstitutional abuse of power. Under our constitutional system, legal businesses get to compete on a level playing field. Concerns about the payday lending industry as a whole should be taken to Congress or the state legislatures where appropriate reforms can be enacted. Concerns about wrongdoing by specific lenders should be dealt with by

[1] *See Gonzales v. Raich*, 545 U.S. 1 (2005) (upholding the federal Controlled Substances Act, which criminalizes the manufacture, distribution, and possession of marijuana even for medical purposes).

the CFPB and the states. If Government, acting without any statutory authority, is permitted to coerce banks into denying service to lawful businesses that the Government simply does not like, then where will it stop? The same power the Government uses today to choke off payday lending and ammunition dealers from banking services could tomorrow be used against convenience stores selling sugary sodas, restaurants selling high fat foods, or family planning clinics. *See* Glen Harlan Reynolds, *Justice shuts down porn money: Column*, USA Today, May 26, 2014, *available at http://www.usatoday.com/story/opinion/2014/05/26/justice-department-porn-stars-first-amendment-column/9594113/* ("while abortion clinics and environmental groups are probably safe under the Obama Administration, if this sort of thing stands, they will be vulnerable to the same tactics if a different administration adopts the same thuggish approach toward the businesses that it dislikes."). The Government should not be in the business of picking winners and losers, and unelected bureaucrats do not get to decide which lawful businesses get to use our banking system and which are choked out. Accordingly, we respectfully request this Court deny the Defendants' Motion to Dismiss.

Respectfully submitted,

/s/ Michelle A. Scott

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