**TESTIMONY**

**of**

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**before the**

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS**
**AND CONSUMER CREDIT**

**U.S. HOUSE OF REPRESENTATIVES**
**COMMITTEE ON FINANCIAL SERVICES**
**WASHINGTON, DC**

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Mr. Chairman, Ranking Minority Member, and members of the Subcommittee, I am profoundly grateful that you are holding this hearing on "Operation Choke Point." The opinions I express today are my own, and I do not purport to speak on behalf of my firm, FTI Consulting, Inc. In the interest of full disclosure, some of FTI's clients have an interest in the matters before the Subcommittee today.

By way of background, I was appointed to the FDIC board of directors at age 34 by President Carter in 1978 and was named Chairman by President Reagan in 1981. I returned to the private sector at the end of 1985 after serving nearly two years beyond my six-year term at the FDIC. I also served during my term at the FDIC as Chairman of the Financial Institutions Examination Council (the coordinating body for the federal regulators of depository institutions) and as a member of the Basel Committee. My CV is attached at the end of this statement.

In my view, Operation Choke Point is one of the most dangerous programs I have experienced in my 45 years of service as a bank regulator, bank attorney and consultant, and bank board member. I fully support the bill introduced by Representative Luetkemeyer, HR 4986, to rein in this program.

Without legal authority and based on a political agenda, unelected officials at the Department of Justice (DOJ) are coordinating with some bank regulators to deny essential banking services to companies engaged in lawful business activities

that some government officials don’t like. Bankers are being cowed into compliance by an oppressive regulatory regime.

History teaches that when government bureaucracies try to direct economies the inevitable results are stifled creativity, distorted markets, and lower economic growth. One of the most insidious ways for government employees to control the U.S. economy is through the banks – directing who gets, and who can’t get, loans and other essential banking services.

Perfectly lawful businesses are being denied access to essential banking services because they offer products or services unelected government officials do not like. This ought to alarm and frighten each of us irrespective of our ideology, party affiliation, or view of the particular products or services being cut off.

Operation Choke Point is a particularly egregious example of an un-Constitutional abuse of power. It is driving lawful businesses out of the banking system, denying them not only loans but also deposit accounts, payments processing services, payroll accounts, and other services critical to operating any business.

According to the Six Month Status Report [HOGR-3ppp00320, 339-340] issued on Operation Choke Point by the House Oversight and Reform Committee, the DOJ launched Operation Choke Point in 2013, working in concert with a wide range of regulators including the FTC, FDIC, OCC, CFPB, and FBI. The

Operation targeted “undesirable” industries. The stated goal of Operation Choke Point was to “sensitize” the banking industry to the risk of doing business with these legal but “undesirable” businesses through the issuance of non-public FIRREA subpoenas ( as opposed to using enforcement actions where the authority and tactics could be challenged).

Regulators and the DOJ highlight some two-dozen businesses that they consider “high risk” or “undesirable”, including ammunition dealers, producers of adult films, check cashers, short-term unsecured loans (commonly called “payday loans”), telemarketers, firearms/fireworks vendors, raffles, pharmaceutical firms, life-time guarantees, surveillance equipment firms, and home-based charities. I have spent my entire professional career in banking and bank regulation, and I do not discern any meaningful increase in risk in providing basic banking services such as deposit accounts, payroll processing, or check clearing services to any of these businesses compared to a host of other legitimate businesses.

By the end of 2013, the DOJ had issued more than 50 subpoenas and entered into one high profile settlement with a depository institution. While the DOJ and other participants in Operation Choke Point were aware of the impact on legal businesses, they did nothing to address this problem or to limit the scope of the program. In fact, they considered this to be a collateral benefit of the Operation.

The DOJ claims it is interested only in fighting consumer fraud and other illegal activities. If that is the case, why are banks being encouraged to refuse to provide basic banking services to companies that are in compliance with state and federal laws? And why are the DOJ and regulators pushing banks to cease doing business with companies engaged in lawful businesses rather than focusing all of their energies on prosecuting the people and businesses actually engaged in criminal behavior?

Operation Choke Point is fundamentally unfair to the banks and legal businesses that find their banking services cut off. By using what it recognizes as an aggressively creative reading of FIRREA's civil subpoena authority, the DOJ contorted the authority granted it in FIRREA to protect banks from fraud into a weapon to use against the banks. Once banking services are cut off to a legal business as a result of subpoena or the threat of a subpoena, there is no chance for the business to appeal the decision. The DOJ seems to think the business can argue with the bank to restore the services. However, there is no allegation of wrong doing by the business that can be disproved. The company is simply in a business that, while legal, has been determined "undesirable" and therefore "high risk" by the federal bureaucracy. This Orwellian result is frightening.

If government employees, acting without statutory authority, can coerce banks into denying services to firms engaged in lawful behavior that the

government does not like, where does it stop? The same power that DOJ uses today to choke off payday lenders or check cashers from banking services could tomorrow be used on convenience stores selling sugary sodas, restaurants offering foods with high trans-fat content, gun manufacturers, gambling casinos, adult film companies, or family planning clinics.

The point is simple and incredibly important. Under our constitutional republic and market-based economic system, unelected government employees should not decide which lawful businesses may have access to banking services and which are to be denied. Those who have serious concerns about payday loans, check cashing services, adult films, family planning clinics, or other products and services should take their concerns to state or federal legislatures and attempt to enact reforms.

It doesn't seem to count for anything at the DOJ, but Congress specifically debated payday lending during the Dodd-Frank deliberations and concluded it is a service utilized and much needed by millions of people, so it should not be eliminated and instead should be regulated by the Consumer Financial Protection Bureau.

The DOJ should not be involved in bank regulation to any extent whatsoever. Its job is to prosecute crimes as defined by law. Bank regulators need to stay out of the political arena and focus all of their energy on ensuring that

banks are operating in a safe and sound manner and are complying with all laws and regulations.  Neither the DOJ nor bank regulators should be allowed to dictate which lawful businesses will be granted or denied access to banking services.

When I was Chairman of the FDIC in the 1980s, the banking agencies developed the CAMELS rating system which measured Capital adequacy, Asset quality, Management capabilities, Earnings performance, Liquidity, and Sensitivity to interest rate fluctuations.  The purpose of this very important endeavor was to bring greater objectivity and uniformity to bank supervision.  Rather than leaving it to each agency and to each regional office within each agency to decide what prudential standards to impose on the banking industry, a uniform, objective, and measureable set of standards was developed.

The primary mission of the FDIC and other agencies prior to the 1980s was unambiguous -- to regulate and supervise the banking system so as to maintain stability and avoid depositor runs and panics.  Beginning in the late 1970s, the agencies were asked to also consider how well the banking system was serving customers across the economic spectrum and across racial, ethnic, and gender lines.

In more recent years the banking agencies have increasingly lost focus on their primary reason for being and have strayed far from their core missions.  One of the most notable examples is introduction to bank supervision of the concept of

so-called "reputational risk." Instead of maintaining laser-like focus on the objective CAMELS ratings, regulators decided at some point during the past two decades to use undefined, nebulous claims about risks to the reputation of banks to pursue unlegislated agendas.

No one really knows what reputational risk means beyond the fact that a bank is doing something that a regulator doesn't like but can't quantify in terms of risk under the CAMELS rating system. This development has been a major factor in shifting the banking agencies from their primary role as guardians of the safety and soundness and stability of the financial system to amorphous financial social welfare agencies.

I believe firmly that management and the board of directors, not a banking agency, should be the guardians of a bank's reputation. Banking agencies clearly have more than enough on their plates in trying to assess the CAMELS factors correctly. Regulators cannot afford to divert time, money, or energy to assessing potential reputational risks about which their expertise is limited at best – particularly when their opinions can cause irreparable harm to lawful businesses as we witness in Operation Choke Point.

If the banking agencies were properly focused on their core safety and soundness mission, they would not be involved in Operation Choke Point. I support HR 4986, the Luetkemeyer bill without reservation. I would be inclined to

add to it a provision prohibiting the banking agencies from considering reputational risk in setting CAMELS ratings or in considering enforcement actions.

Representative Luetkemeyer's bill provides a safe-harbor to promote non-discriminatory access to financial products and services offered by banks and credit unions to businesses that are licensed, registered as money services businesses, or have a reasoned legal opinion demonstrating the legality of their business. The legislation also seeks to rein in the DOJ's subpoena authority by requiring judicial oversight. Importantly, banks and credit unions would retain their legal authority and discretion in establishing or maintaining relationships with existing and potential customers. In other words, bankers would be able to return to making customer decisions based on banking considerations, not political agendas of unelected government employees.

It's time for the rest of us to join this battle before we lose the freedoms that have made our country the most successful nation in the world – with the strongest banking system. The Constitution dictates that the place to debate whether payday lending or any other lawful business should be allowed to operate and have access to the banking system is in the halls of Congress and state legislatures, not in the backrooms of government bureaucracies.

The Luetkemeyer bill is an extremely important step in reining in government agencies that are greatly overstepping their authority and breaching

the Constitutional separation of powers between the three branches of government and between the states and federal government. While some of us may applaud the attack against payday lending, ammunition distributors, or home-based charities, we will likely take a different position when a new administration decides to attack activities more near and dear to our hearts.

I urge Congress to approve the Luetkemeyer bill without delay, as Operation Choke Point is doing severe and irreparable damage to firms engaged in lawful businesses. Thank you again for addressing these important issues and for inviting me to share my views. I will be pleased to respond to any questions you may have.

# BIOGRPAHY WILLIAM M. ISAAC

**William M. Isaac is a senior managing director of FTI Consulting and serves as Global Head of FTI's Financial Institutions practice. The financial institutions group provides regulatory counseling and risk management services, strategy consulting, expert testimony, and corporate governance consulting.**

**Mr. Isaac founded The Secura Group, a leading financial institutions consulting firm, in 1986. Secura was acquired by FTI in 2011. Prior to forming Secura, Mr. Isaac headed the Federal Deposit Insurance Corporation during the banking crisis of the 1980s, serving under Presidents Carter and Reagan from 1978 through 1985. Mr. Isaac serves as a member of the board of TSYS, a leading world-wide payments system processing company and is former Chairman of Fifth Third Bancorp, one of the nation's leading banking companies.**

**Mr. Isaac is involved extensively in thought leadership relating to the financial services industry. He is the author of *Senseless Panic: How Washington Failed America* with a foreword by legendary former Federal Reserve Chairman Paul Volcker. *Senseless Panic* provides an inside account of the banking and S&L crises of the 1980s and compares that period to the financial crisis of 2008-2009. Mr. Isaac's articles are published in the *Wall Street Journal, Washington Post, New York Times, American Banker, Forbes, Financial Times, Washington Times,* and other leading publications. He also appears regularly on television and radio, testifies before Congress, and is a frequent speaker before audiences throughout the world. See www.williamisaac.com.**

**Mr. Isaac served as chairman of the FDIC during one of the most tumultuous periods in US banking history. Some 3,000 banks and thrifts failed during the 1980s, including Continental Illinois and nine of the ten largest banks in Texas. Mr. Isaac was appointed to the board of the FDIC by President at the age of 34, making him the youngest FDIC board member and chairman in history. Mr. Isaac also served as chairman of the Federal Financial Institutions Examination Council (1983-85), as a member of the Depository Institutions Deregulation Committee (1981–85), and as a member of the Vice President's Task Group on Regulation of Financial Services (1984).**

**Mr. Isaac was formerly a senior partner of Arnold & Porter, which was a founding partner of The Secura Group. Mr. Isaac left the firm in 1993 when Secura purchased Arnold & Porter's interest in the firm. Before his appointment to the FDIC, Mr. Isaac served as vice president, general counsel and secretary of First Kentucky National Corporation and its subsidiaries, including First National Bank of Louisville and First Kentucky Trust Company.**

**Mr. Isaac began his career with Foley & Lardner where he practiced general corporate law specializing in banking law (primarily regulatory affairs, including securities matters, acquisitions and branching) and antitrust law.**

**Mr. Isaac is a former member, board of directors of MPS Group prior to its sale to Adecco; former member of the board of directors of Trans Union Corporation; former member, board of directors of The Associates prior to its sale to CitiGroup; former chairman, board of directors, Goodwill Industries, Sarasota; former member, board of directors of Amex Centurion Bank; former member, board of directors, Community Foundation of Sarasota, Florida; former member, board of directors, Out-of-Door Academy, Sarasota, Florida; and former member, board of trustees, Miami University Foundation. Mr. Isaac received a Distinguished Achievement Medal in 1995 from Miami University and a Distinguished Alumnus Award in 2013 from The Ohio State University.**