

PUBLICATION

First Enforcement Action of "Operation Choke Point"

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In a move that has since stirred up controversy on Capitol Hill, the United States Department of Justice (DOJ) in January filed an enforcement action and entered into a consent order with Four Oaks Bank & Trust Company, a small North Carolina bank, for what the Justice Department termed the "use of [Four Oaks] accounts and its access to the national banking system in furtherance of a scheme to defraud consumers."

According to the Complaint, Four Oaks entered into an agreement with a third-party payment processor granting the processor direct access to the Federal Reserve Bank of Atlanta, a clearing house for Automated Clearing House (ACH) transactions. Pursuant to the arrangement, the processor processed more than \$2.4 billion in transactions for its merchant customers. The vast majority of the transactions processed were for internet payday lenders. Other transactions involved alleged internet gambling and an alleged Ponzi fraud scheme. The DOJ further alleged that Four Oaks was aware of the fraudulent nature of the ACH transactions as it received substantial numbers of authorization verification requests from the borrower's banks as well as high numbers of chargebacks, or transaction reversals (including a transaction return rate that was allegedly 21 times higher than the industry average). The DOJ concluded that this arrangement violated the requirement found in the Bank Secrecy Act and the USA Patriot Act that Four Oaks have procedures in place to prevent it from providing access to the national banking system to entities engaged in unlawful activity.

According to news reports, Four Oaks agreed to pay a civil penalty of \$1 million and to forfeit \$200,000 to the United States Postal Inspection Service's Consumer Fraud Fund as proceeds of the fraud alleged in the lawsuit. In addition, the bank is required to assist the federal government in potential criminal investigations arising from the allegations, must commission an independent review of its conduct and must meet specific requirements before it can contract with any third party processors in the future. Specifically, Four Oaks cannot work with any processor that has, in the prior two years, serviced an internet payday lender that has generated transactions in excess of specified return thresholds. Further, Four Oaks must conduct due diligence to verify that any processor is not engaged in any false or deceptive business practice.

The Four Oaks lawsuit is the first enforcement action in the operation the DOJ entitled "Operation Choke Point," a joint action between the DOJ, the Federal Deposit Insurance Corporation and the CFPB to crack down on banks that facilitate allegedly abusive online businesses, including certain online payday lenders. The DOJ issued subpoenas in the Spring of 2013 to more than 50 banks and third-party payment processors in furtherance of the initiative. Additional civil enforcement actions are expected.

After the Four Oaks enforcement action was announced, Representatives Darrell Issa (R-Calif.) and Jim Jordan (R-Ohio), chairs of the House Oversight and Government Reform Committee and the Economic Growth Subcommittee respectively, sent a letter to Attorney General Eric Holder accusing the DOJ of abusing its power in Operation Choke Point. In the letter, Issa and Jordan contended that "the extraordinary breadth of the Department's dragnet prompts concerns that the true goal of Operation Choke Point is not to cut off actual fraudsters' access to the financial system, but rather to eliminate legal financial services to which the Department objects." Issa and Jordan also requested that the DOJ provide records related to the initiative. According to news reports, a spokesman for the DOJ indicated that the Department would respond to the letter.

