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## De-Banking/De-Risking: Issues for the 119<sup>th</sup> Congress

Banks are an important source of financial services in the U.S. economy. Consumers, such as households and businesses, rely on banks for safekeeping savings and for loans when they are short on funds. While access to banking services is widespread, some consumers—particularly some commercial businesses—are not always able to access depository and lending services that banks provide, because banks are reticent to manage relationships that could jeopardize compliance with various banking laws. When a bank terminates an account because the consumer presents a risk to the bank, it is referred to as *de-risking* or *de-banking*. Policymakers grapple with balancing the benefits and risks created by providing bank services. For instance, increased deposit funding and loan revenue are considered healthy financial activities for banks. However, some customers could make it more difficult for banks to comply with certain bank laws, such as the Bank Secrecy Act (BSA).

How and whether banks provide services to certain individuals and businesses is potentially concerning for Congress. This In Focus provides an overview of the issues relevant to accessing banking services among businesses.

### Anti-Money Laundering Framework

The legislative framework for anti-money laundering (AML) policies originated in 1970 with the BSA (P.L. 91-508). Over time, the BSA has been amended and expanded, and the key elements to the BSA's AML framework include a customer identification program, transaction recordkeeping, transaction reporting, and compliance programs intended to identify and prevent money laundering.

The BSA's AML framework requires banks and other covered financial institutions to file a range of reports with the Financial Crimes Enforcement Network when their clients engage in suspicious financial activity, large cash transactions, or certain other activities.

### Regulatory Framework

There are three federal bank regulators: the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve. These agencies supervise banks for safety and soundness and compliance with various banking laws, using their enforcement authorities to compel banks to comply with banking laws. If a bank does not comply with the law, it can face monetary penalties, restrictions on its activities, and even being shut down.

Other federal financial institution regulators also conduct oversight and examine entities under their supervision for compliance with BSA/AML requirements. These regulators

are responsible for the safety-and-soundness examinations of the institutions they supervise and generally conduct BSA examinations. When there is cause to do so, the regulators may carry out a special BSA examination.

Enforcement actions for AML violations may result in civil and/or criminal penalties. Other federal agencies with AML responsibilities include the Securities and Exchange Commission and the Commodity Futures Trading Commission. The Internal Revenue Service also enforces BSA compliance, particularly for nonbank financial institutions not regulated by other federal agencies, such as money service businesses, casinos, and charities.

### De-Risking or De-Banking

As mentioned above, banks may terminate accounts for a variety of reasons. For example, a bank may not wish to do business with a company because it believes the company could pose a risk to the bank's ability to comply with the BSA. Banks are frequently subject to enforcement actions for BSA/AML violations.

This example is prominent among certain types of financial institutions that have bank accounts, such as money transmitters, which have relatively low margins and may not be profitable customers for banks. Money transmission is largely built around sending remittances overseas. A bank has a responsibility to perform customer due diligence on its account holders to ensure they are unlikely to undertake prohibited activities. So if a money transmitter were to be (knowingly or unknowingly) involved in some illicit transfer of funds, such activity could be considered in conflict with the bank's regulatory expectations. Thus, a bank may choose to avoid relationships with firms in this industry to reduce their compliance risk. Thus, some companies in industries that are perceived riskier may have a more difficult time accessing basic banking services even if they are in good legal standing.

Another example is that a commercial client could impact the bank's reputation. For example, a bank that provides services to gun manufacturers may believe that it would be subject to reputational risk and may seek to terminate relationships with those companies. Thus, companies in industries where reputations are potentially controversial could be subject to de-banking despite not breaking any laws themselves.

Finally, there is occasionally conflict between state and federal law. Although most banks are state-chartered, every federally insured bank has a primary federal regulator, and generally these regulators expect banks to avoid banking with clients that violate federal law. One example is cannabis businesses. Cannabis is legal in several states but

is banned at the federal level. Thus, a bank chartered in a cannabis-legal state may be in a position to provide banking services to a company operating legally under state law, but it could potentially violate federal law. Thus, banks may choose not to bank with companies in industries that are legal only at the state level due to potential bank exposure to legal risk.

### Regulatory Conflicts

Banking regulators are concerned with the health of financial institutions and banks' compliance with banking law. These two priorities can be in conflict with one another. For example, regulators may want a bank to increase its deposit base to increase its stable funding source, but if a deposit account is held by an entity that facilitates illicit activity, that bank may be unable to meet its regulatory expectations.

Further, de-risking has two negative consequences for bank regulators: It can reduce the deposit base of the banking system, and it can increase the level of financial activity outside of the banking system. This could in turn lead to outcomes outside of regulatory control, impacting financial stability and potentially weakening compliance and/or enforcement of various laws.

### Ideological Discrimination vs. Prudential Risk

Whether bank regulators are incentivizing de-risking to discriminate against certain types of businesses on ideological grounds or banks are unable to properly manage risk in some areas and thus limit services to those companies is a debated question. As mentioned above, reputational risk is increasingly important to banks, and a bank doing business with a client could sway public opinion about the bank and impact other customer relationships with the institution. Further, if a regulator believes an industry generally presents some sort of risk, banks may be less willing to do business with enterprises in that industry even if they are good-faith customers.

In 2013, bank regulators were accused of targeting financial institution engagement with certain commercial operations as “high-risk activities” as part of a Department of Justice investigation effort informally named “Operation Choke Point.” The operation was designed to identify industries that posed a risk of consumer fraud and to limit their ability to perpetrate this fraud through the financial system.

Some banks had reportedly terminated accounts with certain customers due to claims of increased regulatory scrutiny as a result of the investigation. Several large banks had reportedly terminated accounts with clients on a list of these reportedly “high-risk” companies.

Some have argued that during this period, regulators were effectively seeking to stifle access to financial services among certain industries that were ideologically misaligned with the White House. While bank regulators and Department of Justice denied the claim that ideology fueled the effort, it highlights the kind of tension regulators

balance when weighing the costs and benefits of access to the banking system.

### Cryptocurrency and De-Risking

Some Members of Congress have also expressed concerns that regulators have pressured banks to terminate relationships with firms operating in the crypto industry. At times, they have drawn parallels between those alleged efforts and Operation Choke Point, characterizing certain policies as representing “Operation Choke Point 2.0.”

### Payments

A current debate in the payment system parallels Operation Choke Point. Merchant Category Codes (MCCs) are codes used by the payment system to price risk of illicit activity. Financial institutions use MCCs to identify thousands of industries and subindustries. MCCs can be used by the government for tax purposes or by the private sector to facilitate pricing for certain payment processes. Some states require credit card companies to use a unique MCC for gun merchants, citing credit card fraud in several court cases concerning gun purchases. Other states have done the opposite, banning unique gun MCCs on the grounds that it violates personal privacy.

### State vs Federal Laws

Another policy concern is how federal bank regulators should handle bank activity with businesses that are legal at the state level but illegal federally. As mentioned above, cannabis banking sits at the nexus of this issue, where state-chartered banks are in position to provide banking services to companies that operate legally under state law but illegally at the federal level. Because each commercial bank has a primary federal regulator, this creates conflict for federal banking agencies to avoid condoning federally illicit activity while also avoiding influencing commerce at the state level that exceeds the prudential authority of the regulators. Further, some regulators have issued enforcement actions related to cannabis banking. Recent legislation (H.R. 2891/S. 2860) was aimed at protecting such bank relationships by providing safe harbor to banks from federal agency action.

### Resources

CRS Report R44776, *Anti-Money Laundering: An Overview for Congress*, by Rena S. Miller and Liana W. Rosen

CRS Legal Sidebar LSB11076, *Marijuana Banking: Legal Issues and the SAFE(R) Banking Acts*, by David H. Carpenter

CRS Report R46486, *Telegraphs, Steamships, and Virtual Currency: An Analysis of Money Transmitter Regulation*, by Andrew P. Scott

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