
Community banks' cannabis dilemma



In the fight between states and the federal government over whether buying and selling cannabis should be legal, community banks are stuck in the middle.

By Judith Sears

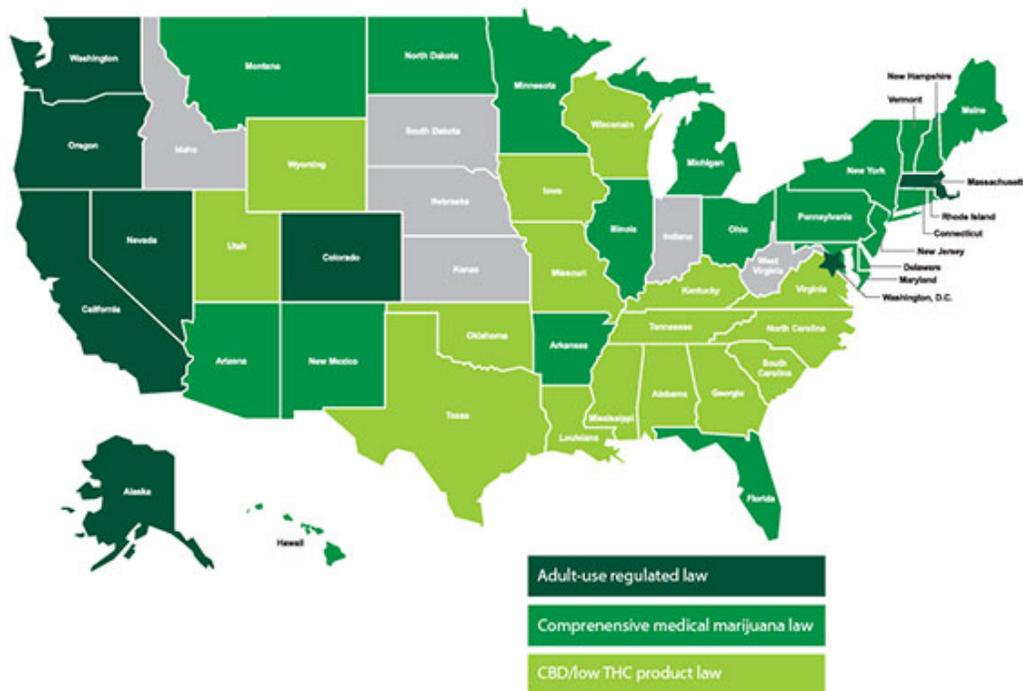
As the owner of a national cable TV contracting firm, Bruce Nassau of Denver, Colo., had done business with a regional bank for many years. But when he sold his cable TV business and purchased a marijuana dispensary, things changed. “Now that I was in the marijuana business, they said, ‘We can’t bank you,’” Nassau recalls. “I sat down with the president and CEO and said, ‘You know I keep large sums of money at your bank that you know are derived from cable TV.’ That didn’t do it. They said their concern was with the regulators.” Nassau subsequently found a state-chartered bank—which he declines to name—to do business with, but he knows many cannabis entrepreneurs have not been so fortunate, even in a state where it’s legal to sell marijuana. “I know people who’ve had to go to a new bank every few months,” he says.

Nassau’s plight and the banks’ dilemma reflect the contradictory legal status of marijuana in the US. At the federal level, marijuana is listed as a Schedule 1 drug under the Controlled Substances Act, classed with heroin, LSD and ecstasy. Financial transactions involving the proceeds of such substances can be the basis for prosecution. However, citizens of 28 states plus the District of Columbia have voted to legalize medical marijuana, according to the National Conference of State Legislatures.

That puts the banks and the industry in the middle of a federal–state standoff. “As long as marijuana is considered a Schedule 1 drug at the federal level, that is a very big challenge,” says **David Haithcock, executive vice president, executive director, California Community Banking Network**. “State laws allow for this business to be legal, but banks aren’t comfortable doing business with them because there’s a risk that their charters could be threatened.”

Where is cannabis legal?

Some states allow recreational use, while others have banned it entirely.



Haithcock, who serves on the California state treasurer’s Cannabis Banking Working Group, notes that banks, like citizens, are divided on the subject. “We have community banks that don’t make loans to liquor stores and don’t want to support marijuana from a moral standpoint,” he observes. “Other banks believe that if marijuana is made legal in the state, and they’re dealing with a legal entity, they will bank that legal entity.”

ICBA has not taken a pro or con position on the legalization of marijuana. “Our position is, how can we help community banks if marijuana is legal, and how can we help guide them in the current situation where it is legal at the state level?” says Lilly Thomas, ICBA senior vice president and

senior regulatory counsel.

The legal picture may be murky, but the marijuana industry is thriving. In 2016, North America saw \$6.9 billion in retail sales of marijuana. Recreational use of marijuana was only approved in November in California, but Haithcock puts the California market potential in the neighborhood of \$7 billion. Sales in 2016 for Colorado and Washington were \$1.3 billion and \$1 billion, respectively.

States and financial institutions struggling to respond to the street-level reality are using the 2011 Department of Justice “Cole Memo” and the Department of Treasury’s 2014 FinCEN Guidance as an interim framework for banking marijuana-related businesses (MRBs).

The Cole Memo, issued by US Deputy Attorney General James M. Cole in response to states seeking guidance on authorizing marijuana for medical use, outlined the federal government’s enforcement priorities as preventing youth access, preventing the transportation of marijuana across state lines and preventing gang and criminal elements from gaining access to the system.

Following the lead of the Cole Memo, the 2014 FinCEN guidance gave more details on how banks could carry out due diligence. Because, in addition to the Cole Memo and FinCEN guidance, banks are required to strictly follow BSA and AML regulations, the due diligence requirements for banking MRBs may seem daunting, never mind whether Uncle Sam is cool with it.

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Ironically, however, states that have legalized marijuana have regulated the industry along the lines of other high-risk industries, such as alcohol or casinos. And a highly regulated cannabis industry can make community banks’ jobs easier, especially if they are given access to the voluminous paper trails generated by such oversight.

Due diligence

For example, licensing of MRB owners and investors generally follows a rigorous vetting process, including criminal background checks and financial disclosures. “This gives the banks some assurance that they’ve gone through a background check and disclosed where they got the money to start the business,” says Rick Garza, director of the Washington State Liquor and Cannabis Board (WSLCB), which turns over to banks all of this background information once the MRB has signed a waiver. “If you’re more rigorous in vetting, then the state banks are more likely to consider banking MRBs.”

The WSLCB has created a detailed and widely admired “seed to sale” traceability system that provides monthly MRB sales reports so that banks can compare what MRBs are reporting as sales with amounts moving

through their accounts. In addition, the WSLCB will provide banks with information on any enforcement actions or violations that may have occurred with their MRB accounts on a quarterly basis. “That’s transparency,” Garza declares.

Lewis Koski, who served as deputy senior director of enforcement for the Colorado Enforcement Division during the time Colorado legalized marijuana, is optimistic that as the regulated market matures and gains credibility, more banks will be comfortable banking MRBs.

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“As regulators, we worked hard to create regulations that helped fill the void, such as a robust inventory tracking system and very comprehensive surveillance systems like what you see in a casino,” Koski says. “Regulations that ensure the likelihood of accountability of product go a long way to making banks more comfortable.”

Federal barrier

Despite these state-level workarounds and initiatives, however, federal law hasn’t changed. As a result, more banks than not remain on the sidelines, leaving much of the cannabis-related industry to conduct business on a cash basis, including paying employees, vendors and taxes in cash.

“Employees can’t get a paycheck,” Haithcock reports. “Our Board of Equalization, California’s taxing entity, receives truckloads of cash.”

Those in favor of banking marijuana are quick to point out the public-safety implications of billions of unbanked dollars floating around. Advocates also emphasize that normalized banking services for MRB will help reduce misuse of the banking system by criminal elements.

“It’s difficult to follow the path of where the money is going if it’s not coming from a financial institution,” Garza points out.

“It’s easier for us to keep track and regulate the industry if it’s moving money that can be monitored.”

Currently, no one is sure what tack the Trump administration will take—whether it will introduce new guidance or leave the guidance as is. “The California Cannabis Banking Working Group had hopes that the Trump administration would be open to working through some of these conflicts, but [US Attorney General Jeff] Sessions has indicated an inclination toward enforcement,” Haithcock says.

Ultimately, advocates agree that the solution to banks' dilemma must be a legislative one, with Congress reclassifying marijuana or creating some other legislative carve-out. "Legislation is the only thing that will give banks the 100 percent safety they're looking for," Thomas concludes.

Judith Sears is a writer in Colorado.