

Implications (Conclusions) of the Legalization of Marijuana and the Conflict Between the FinCEN/DOJ Guidance and Federal Law

“Comprehensive” Outline for CBA comments to Florida International Bankers Association in Miami March 2015 (1,400 attendance) – along with speakers from DoJ and FinCEN

- 1) Conclusion – only remedy is literally an Act of Congress, several years away
 - a) Why
 - i) Controlled Substances Act: Federal crime to possess or distribute controlled substances or proceeds therefrom
 - ii) BSA: monitor customer accounts for suspicious activity associated with crimes/terrorism and report via SARs
 - iii) SARs: cause nearly all bank accounts for MJ to be shut down immediately once discovered – because suspicious illegal activity or undesirable re cost/risk to bank
 - iv) And AML definition: bank doing money laundering by accepting MJ deposits
 - v) DoJ and FinCEN can't define away the prohibition in Controlled Substances Act
 - vi) No one except Congress can resolve this – not FinCEN, not Treasury/Justice, not Fed/FDIC/OCC, not DEA, not states
 - vii) Honestly don't care much what FinCEN, DoJ or DoT say – it is bank regulators that concern us – and no case law resolving conflicts of law/regulation
 - viii) Banks are not willing to be guinea pig when penalties (PCA, CMP, C&D, fines...) can be so extreme
 - ix) Must wait for Congress
- 2) Development
 - a) Constitutional amendment
 - i) Development
 - (1) Medical since 2001
 - (2) Recreational since 2012 election (54%-43%), 2013 rules & prep, 1/1/14 permitted
 - ii) Where permitted
 - (1) it is allowed in 26 states including D.C., and Florida voters fell just shy of approving medical marijuana in November
 - (2) Alaska and Oregon approved legal marijuana sales for recreational use, joining Colorado and Washington. District of Columbia legalization of possession and transfer of small amounts of marijuana voted by a 2-to-1 margin, met a Congressional veto late 2014. The issue is expected in Arizona, California, Massachusetts, Maine and Nevada.
 - iii) Complications
 - (1) NE & OK
 - (a) the first major court challenge saying that CO's MJ shops are piping marijuana into neighboring states and should be shut down under the supremacy clause of the U.S. constitution.
 - (b) The attorneys general in NE and OK ask the United States Supreme Court to strike down key parts (not all) of a 2012 voter-approved measure.
 - (c) Sheriffs and police officers in rural counties bordering Colorado have complained about marijuana entering their towns and transported on their highways since CO recreational sales began in January 2014. OK and NE said the influx had led to more arrests, more impounded vehicles, higher jail and court costs, and has forced law agencies to spend more time and resources to MJ-related enforcement.
 - (d) Chance of success? Standing? Merits?

- (e) MJ advocates said that the challenge — if it succeeds at shutting down marijuana retailers — could boost the black market.
 - (2) Another suit by individuals seeking to overturn the CO law.
 - (a) Also based on supremacy clause
 - (3) Sheriffs in three states including CO have brought suit to have Colorado marijuana provision in the CO Constitution declared void as against federal law
 - b) Colorado rules & regulations
 - i) Drafted quickly – 90 days – TF & numerous, diverse working groups
 - ii) Worked well except for edibles – strength & labeling
 - iii) Banking was an early topic – initially most nonbankers disagreed with CBA’s assessment that only Congress can resolve but now after a year all are in agreement
 - iv) Rules written in 2013 Rules address personal use (who, where, amount, security requirements, self-grow...), DUI, employers’ zero tolerance, impact on contracts, consumption similar to alcohol, similar penalties, and can’t export out of CO; and licensing of cultivation facilities, product manufacturing facilities, testing facilities, and retail stores
 - c) Early & continued concern about banking availability
 - i) 8 known providers in CO (small banks on very small scale) – not known to public or MJ community – traits they share
 - (1) Small banks
 - (2) History of banking marijuana transactions – under Colorado’s medical marijuana law over the last decade
 - (3) History of banking that specific customer – also under Colorado’s medical marijuana law
 - (4) Few marijuana customers
 - (5) No growth in MJ business either in number of customers or in volume from them
 - (6) Bank’s Board acknowledgement of risks involved
 - (7) Rigorous BSA and AML compliance program
 - ii) With only extremely limited banking, the bulk of the industry (cultivation, manufacturing (processing), testing, and retail) deals in cash – numerous stories – armored car services scared off by DEA, ex special forces and navy seals transporting funds; pay employees, vendors, rent and utilities, state taxes in cash, pay IRS + 10% penalty for cash
- 3) Banking availability
- a) Went from “Don’t ask, don’t tell” by banks in early days to “Do ask, do tell” attitude by banks to decline MJ business
 - b) Why can’t – CSA, BSA, AML...
 - i) Background: banks are conservative institutions – not politically but in judgment
 - ii) Controlled Substances Act, Schedule I drug, since 1970, when Congress made it illegal to manufacture, possess or distribute it, or deal in the proceeds therefrom.
 - iii) Banks don’t want to put themselves in jeopardy by opening accounts or receiving any money—even indirectly—from the sale of marijuana for fear of violating drug laundering laws and being shut down.
 - iv) Bank Secrecy Act is a hurdle – mandated reporting via Suspicious Activity Reports of suspicious activities under federal law
 - v) Anti-Money Laundering Act is another hurdle. Definition: *The process of taking the proceeds of criminal activity and making them appear legal.* So in the eyes of conservative bankers and conservative legal counsel the bank itself is the money launderer.

- vi) April U.S. Senators Feinstein (D-CA) and Grassley (R-IA) wrote FinCEN after it issued the February guidance. Two Senators challenged the authority of FinCEN to give guidance to violate federal law. question 7: can the SAR filed by the bank on an MJ transaction be evidence against the bank when it is prosecuted for aiding and abetting a violation of federal law
- vii) Elaborate and expensive compliance programs, well trained staff, internal controls and independent audit outside of MJ – knowing your high risk customers, enhanced customer due diligence, red flags indicating unusual or suspicious activity, detection and reporting requirements under BSA – compliance mechanism in place (other than MJ) but MJ too risky
- viii) Old standard: Know Your Customer – some examiners even to Know Your Customer's Customer – work that entails re knowing typical amounts and sources of revenue...
- ix) Then MJ – banking not an issue for over a decade of medical MJ use, problem arose under recreational and media attention
 - (1) Repeated DoJ/FinCEN guidance (several iterations), each one showing that wasn't stable and could be changed next month
 - (2) Bank regulators (Fed, FDIC, OCC) inconsistent verbal directives; inconsistent within an agency – FDIC order one bank to close 80+ accounts and they would verify in 30 days, penalty is no FDIC insurance
 - (3) DEA visits: shut down or we'll be back with search warrants
 - (4) Perception by some that prosecution is what we fear; but it is minor to real threat: action or criticism by bank regulators

4) FinCEN/DoJ

- a) State had hoped new rules issued last year by FinCEN would reassure banks.
- b) CBA reaction – That didn't allay bankers' fears, however. Colorado bankers became even warier. We said, "It is all but impossible for any institution to comply with the 'Know your customer's customer' burden outlined in the FinCEN and Department of Justice memos issued in February, which include ensuring marijuana isn't used on public land, resold, transported outside of Colorado, provided to minors or other factors."
- c) 2/14/14 DoJ/FinCEN memos
 - i) Repeated chilling language:
 - (1) Additionally, financial institutions that conduct transactions with money generated by marijuana-related conduct could face criminal liability under the BSA for, among other things, failing to identify or report financial transactions that involved the proceeds of marijuana-related violations of the CSA. See, e.g., 31 U.S.C. § 5318(g). Notably for these purposes, prosecution under these offenses based on transactions involving marijuana proceeds does not require an underlying marijuana-related conviction under federal or state law.
 - (2) Similarly, if the financial institution or individual is willfully blind to such activity (8 enforcement areas) by, for example, failing to conduct appropriate due diligence of the customers' activities, such prosecution might be appropriate.
 - (3) Financial institutions must continue to apply appropriate risk-based anti-money laundering policies, procedures, and controls sufficient to address the risks posed by these customers, including by conducting customer due diligence designed to identify conduct that relates to any of the eight priority factors.
 - (4) This memorandum does not alter in any way the Department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law.

- (5) Nothing herein precludes investigation or prosecution, even in the absence of any one of the factors listed above, in particular circumstances where investigation and prosecution otherwise serves an important federal interest.
- ii) 8 – focus enforcement resources on persons or organizations whose conduct interferes with any one or more of the following important priorities (the “Cole Memo priorities”):
 - (1) Preventing the distribution of marijuana to minors;
 - (2) Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
 - (3) Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
 - (4) Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
 - (5) Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
 - (6) Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
 - (7) Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
 - (8) Preventing marijuana possession or use on federal property.
- iii) Green light
- iv) CBA: generally red, but yellow at best – because public funds above
- v) Major media attention
- d) No change – FinCEN said in August that only 105 banks and credit unions—a tiny fraction of the 7,000 banks and 8,300 CUs in the U.S.—take money from legal marijuana businesses. 105 out of 15,000 institutions is .7%
- 5) Our advice
 - a) Each bank makes own call
 - b) Don't think of offering services to MJ businesses until real green light from bank's own legal counsel (major law firms won't touch MJ businesses until banking because paid in cash)
 - c) Review any plans with your regulators
 - i) Same examiners who sternly warned the bank verbally to close accounts
 - ii) From DoJ/FinCEN in Feb until fall of 2014 silence or inconsistent directives from examiners
 - iii) In fall 2014 bank regulators shifted to a new tone “It's the bank's call; we won't tell them to do it or not.” But most people don't understand the power of bank examiners – banker concern about FDIC insurance being discontinued, Prompt Corrective Actions, Memorandums Of Understanding, Cease and Desist Orders... if nothing else they can criticize and conceivably remove management for poor judgment in banking an illegal activity
 - d) Proceed with caution.
 - i) There are not clear regulatory policies, guidance, examiner training, exam usage
 - ii) There are not consistent regulatory policies, guidance, examiner training, exam usage – either between agencies or within some agencies
 - e) MJ leader: Before the Valentine's Day memo, many of the businesses had bank accounts in a don't-ask-don't-tell, unstable environment turned into previously willful banks were suddenly auditing themselves, unable to pretend anymore. In one moment, things went from bad to worse.

- f) One major paper: "Valentine's Day memos were seen by some as a green light to banking. Bankers, however, saw it as a very dim yellow one, and most balked at rules requiring even more paperwork to identify marijuana-tainted money."
- 6) CBA supports Congressional fix
 - a) Why fix needed – public safety, reg or tax, "legal" businesses
 - b) Others don't have authority – bankers don't believe any amount of memos can change CSA
 - c) Relying solely on cash leads to a lack of transparency in accounting and auditing, and it complicates paying the taxes that states impose on cannabis.
 - d) The problems caused by a cash-and-carry retail business likely will grow as more states move to legalize pot for medical or recreational use, unless Congress acts
 - e) No one else has authority
- 7) State's efforts – CBA skeptical
 - a) In the absence of Congressional action, CO tried to solve the problem on its own.
 - b) Private – third-party middleman handles banking and bookkeeping to relieve some of the burdens on the financial institutions. deposit still against federal law
 - c) Pot coop
 - i) In May, a bill was introduced to create Cannabis Co-ops to provide specified financial services to marijuana businesses. CBA was neutral after we obtained all 14 of the amendments we requested but we testified and informed the media that we are confident the proposed co-ops can't work, but that this effort by Colorado sends a message to Congress that the State has tried everything it can and only Congress can resolve this issue.
 - ii) That reason is that without banking services, the marijuana businesses are a public safety threat due to their excessive cash and the state's inability to tax and regulate them
 - iii) Correspondent banks will not touch the coop.
 - iv) No Fed access, doubtful, therefore no payment system access – checks, credit/debit cards, ACH, ATMs...
 - d) Pot credit union
 - i) Fourth Corner Credit Union for pot – chartered by CO but no CU insurance and no Fed access (payment system) – proponents naively thought fed access should be automatic – inaction (no) is what I predict
 - (1) Colorado has said Fourth Corner is the last thing it can do to try to solve the problem of too much cash on the streets and no banking services for marijuana industry.
 - (2) It is doubtful that checks and/or drafts drawn on these accounts at the credit union will be accepted by other institutions since an accepting bank will be on notice that funds coming from that institution are related to a federally illegal activity for BSA and AML purposes.
 - e) M-Bank
 - i) Portland bank announced it would serve the MJ business and 2-3 days later said it would not
 - f) State owned bank
 - i) Discussed – Concept: government owns a bank
 - ii) Why won't work – still no access to the payment system
 - g) Despite the CO approval of the credit union and recent cooling by federal regulators, CBA maintains its position that any bank serving the industry does so at its own risk. We believe it is all but impossible for any institution to comply with the "know your customer's customer" burden outlined in the FinCen and DOJ memos issued in

February which include ensuring Marijuana isn't used on public land, resold, transported outside of Colorado or otherwise provided to minors.

h) Hickenlooper's comments in State of State:

- i) We have worked from scratch, with many parties to develop robust regulations that allow the industry to develop and prosper in a safe and legitimate way. Both the Brookings and the Cato Institutes have commended our work.
- ii) Challenges remain: first and foremost banking. We will continue to push the federal government to allow banking for this industry.

8) Prospects in Agencies

- a) We doubt NCUA is willing to go against this by authorizing NCUA insurance.
- b) We believe that the Fed will not provide access to the CU – such approval effectively would speak for the Fed, bank regulatory agencies, executive branch and Congress. The Fed needs friends; doesn't have many.

9) Prospects in Congress

- a) In July an amendment (to H.R. 5016) intended to make it more difficult to bank marijuana entities was defeated in the U.S. House, failed by 186-236. Then, an amendment intended to make a statement permissive of banking marijuana entities was adopted, passed 231-192.
 - i) No teeth; just amounts to a political statement, yet...
 - ii) Colorado's Members of Congress: Dems and half the GOP supported, ½ the GOP opposed
- b) Congress recently went on record again in the omnibus appropriations bill by vetoing the WDC vote on marijuana.
- c) A bill by Rep. Ed Perlmutter, a Colorado Democrat, would explicitly allow banks and credit unions to provide banking services to legal marijuana businesses. It died in the last session of Congress. Will be reintroduced. Rep.'s Polis and DeGette had their own.

10) Status

- a) Statistics (various sources): • CO annual MJ demand is 130 metric tons • 74% of sales are medical MJ, 26% are recreational (dues to lower prices/taxes, and more medical dispensaries) • 485,000 users 21 or older (9% of population) • out-of-staters buy 7% of pot in CO • 90% of pot sales in resorts are to non-Coloradans, 10% elsewhere • 23% of users consume daily • 104,000 medical MJ patients report severe pain as their need • 9% drop in retail price January 2014 to December 2014 • 9% of MJ users risk addiction
- b) Denver Police: • price 3x CO prices elsewhere so illegal incented • more DPD resources in vice unit and in licensing, • 38% fewer arrests, 318% more consumption • public issue no longer arrest but citation (\$100 fine, many not pay since homeless) • growth in homeless – attracted because jobs here (but they drug test...) or came to enjoy • 11% of burglaries are MJ • crime insignificant but takes more resources • 3 trips to WDC to get fed gov to address re safety
- c) Approx. 2014: \$400M medical sales, \$300M recreational sales, \$72M in taxes (suspect expenses exceed – example: emergency room admissions of adolescents/juveniles for drug overdose tripled)
- d) Children's hospital:
 - i) Children <10 accidentally ingest edibles way up – some in ICU, ventilators
 - ii) Families who want to treat children – empathy, but no research, but hospital has 4 projects underway
 - iii) More babies born with MJ in system (nursing moms, morning sickness, not educated)
 - iv) 2nd hand smoke for young children

- v) Many problems re tweens & teens
- e) Edibles (candy/food, oils/tinctures): 5.5 million units (each containing numerous doses) sold in 2014: for candy/food 2.8 M in recreational, 1.9 M in medical; oils/tinctures 0.4 M in recreational, 0.4 M in medical
- f) CO:
 - i) 502 licensed medical, 355 licensed recreational, 261 infused product manufacturers, 16 testing labs – 1,100 MJ businesses, we estimate 50 are banked (about 4% of businesses)
 - ii) 116,000 medical registry ID cards
 - iii) 12,000 with an occupational license to work in MJ
 - iv) Per square foot, MJ grow operation uses 356% of electricity as to run a hospital – nationally 1% of electricity consumed by MJ
- g) Banks' withdrawal – anecdotes
 - i) General
 - (1) AP: growing number of homeless people who recently moved to Colorado seeking its legal marijuana, and who remain in the state and occupy beds in shelters – older ones are coming for medical, the younger ones just because it's legal – Salvation Army has more than doubled its staff to accommodate the increase – survey: 30 percent of new out-of-towner homeless had relocated for pot
 - (2) In late October Denver police and federal agents raided multiple marijuana growing operations across Denver. Those came 11 months after local and federal authorities raided several large marijuana businesses. Therefore, unstable environment.
 - (3) Nearly all of the banks refuse to take money from marijuana sales or offer basic checking or credit card services to the industry and generally won't do business with growers, processors, retail shops and medical dispensaries, and some won't bank their employees and contractors.
 - ii) Deposit accounts – for bill pay, to process cards... – not if we catch you – by the way we don't like being the government's enforcer
 - (1) Openly – NO
 - (2) Surreptitiously – not if we catch you – smell at first, then Fabreeze, now literally laundering the money
 - iii) ATMs
 - (1) Late Oct hundreds of cashless ATM machines (allows customers to get a receipt good for purchases in that location directly through a credit or debit card) located in medical marijuana dispensaries, just days after similar machines were unplugged from recreational shops.
 - (2) MetaBank told providers in January 2014 that machines could not be located in marijuana businesses because the sale and consumption of pot and infused products remains illegal under federal laws. MetaBank took the machines offline.
 - iv) Credit/debit cards – similar stories of terminals being deactivated for physically removed
 - v) Loans – no, we won't finance – because illegal activity makes whole property subject to federal seizure (rarely done), but to bank examiners that means the bank has no collateral and thus is required to write the loan off that day (a real no-no) – doesn't mean customer doesn't have to pay
 - vi) Correspondent banking – big bank for smaller bank – fear the correspondent bank will be legally contaminated by accepting deposits from small bank that serves MJ business

- vii) Lawyers and CPAs have helped disguise transactions by MJ businesses
 - h) Confusion continues
 - i) BSA/AML Exam Manual ???
- 11) Conclusion – Only Congress can change this.

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