

## The First Bank of Bud

# Marijuana Industry in Colorado, Eager for Its Own Bank, Waits on the Fed

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It was zero degrees in Denver on a late December morning, and the ice-covered streets were mostly empty. Mark Mason, wearing a full-length black coat, green wool hat and sunglasses, sat in a white Buick LaCrosse, eyeing the squat building across the street. It was the local branch of the Federal Reserve Bank.

“Behind that gate, that’s where the armored cars come in,” he said, pointing to a parking lot. “They’ve got a bunch of money in the basement — a bunch.”

For some months, Mr. Mason, 54, has been thinking about the bank and how, he said, “to break in.” Not to take money, but to leave it. Mr. Mason and a group of other entrepreneurs in Colorado want to start the first-ever financial institution established specifically to serve the pot industry. To do that, they need to make deposits in a Federal Reserve account, and the agency hasn’t let them. Such humdrum administrative decisions are made all the time by federal banking officials, but this one raises big political and legal issues between the federal government and the state of Colorado over the legalization of marijuana.

Mr. Mason and his business partners have already received a license from the state of Colorado for their Fourth Corner Credit Union. They have leased a building in downtown Denver, put up a Facebook page and generated predictable jokes on late-night TV. Jimmy Fallon: “If you think the line is slow at *your* bank ...”

Medical marijuana has been legal in Colorado since 2009 and recreational marijuana use became legal a year ago. But marijuana businesses have had limited, if any, access to banking services. The federal government considers marijuana illegal and so traditional banks, fearing prosecution for aiding and abetting illegal drug dealers, have shut down pot-business accounts and declined to give loans. Some banks have ferreted out pot entrepreneurs by sniffing their bills, leading to a countermove: bills sprayed with air freshener.

Without a bank account, pot businesses deal in cash, lots of it, held in safes, handed out in clipped bundles on payday, carried in brown paper bags and cardboard boxes to the tax office and the utility company, ferried around the state by armored vehicles and armed guards. And without access to essential banking services — from credit cards to electronic transfers to loans — those businesses pay a huge premium. The reality in Colorado is that it is legal to grow pot but extremely hard to grow a pot business.

The Fourth Corner partners saw a need and a business opportunity. State accreditation in hand, the partners took a step this November that typically goes off without a hitch: they applied to the Federal

Reserve Bank for a “master account.” This is the account they would use to deposit funds and transfer them electronically with other banks — the lifeblood of commerce.

Mr. Mason could not find a case of a state accredited financial institution being denied a master account. Usually, approval comes in days, he noted. But it has been nearly three months since the application was filed and there has been no answer, just a letter in early January saying the request was under review. Mr. Mason said the application was on the desk of a specialist in bank risk, a guy named Ryan Harwell in Kansas City, the Fed’s Midwest regional office that oversees the Denver branch.

While the Federal Reserve declined to comment — as a matter of policy, its officials don’t comment on pending applications — Mr. Mason suggested a reason the Fed may be wary of granting the account.

“This legitimizes the marijuana industry to the extent it’s never been legitimized before,” he said. If Fourth Corner gets approval, businesses would have a place to deposit and to borrow. Other institutions might well follow, and the federal government “would become complicit, and the walls start tumbling down.”

At the same time, Mr. Mason argued that the Federal Reserve Bank was not only within its rights to approve the credit union but was obliged to do so.

Peter Conti-Brown, a banking expert at the Stanford Law School, agreed that the credit union application set up a quandary, one that, as policy questions go, is “delicious” and “awesome.” Yes, in theory, he said, the Fed could approve this credit union. But the implications are unclear, and potentially staggering, he said, given that this pen stroke by Mr. Harwell could let the cannabis industry blossom. And then what happens to the federal government’s power over pot?

“I can almost see his green shaded visor and glasses,” said Mr. Conti-Brown, imagining Mr. Harwell in Kansas City. “All of a sudden on the desk of this midlevel bureaucrat comes an extraordinary question of federal policy and constitutional law.”

### *A Crack in the Door?*

The possible future home of the Fourth Corner Credit Union is seven blocks from the Federal Reserve’s Denver branch in a ranch style, 2,100-square-foot building that once housed an office of the Colorado Business Bank. It has four teller windows, one of them drive-through, a convenient side alley for armored cars to pick up the cash to take it to the Fed, and a collection of neighbors that, as Mr. Mason likes to say, represents “the whole universe” — the United States Mint, the state courthouse and the Diamond Cabaret strip club.

Mr. Mason only recently moved to Denver. He rents a condo with his wife downtown, but his permanent home is in Charleston, S.C., where he practices law. He grew interested in the whole bank-for-pot idea after getting a call from his son, Alex. A recent college graduate with a degree in criminal justice, the younger Mr. Mason was living in Denver and told his father that friends in the marijuana industry were struggling to find banks to take their money. Mr. Mason stayed up all night, inspired, writing a 20-page position paper on banking law, and then started making local contacts, first with high-powered Denver lawyers. He said he was captivated by the “opportunity to work on one of the great political, social and constitutional issues of the day,” one that made his day job “pale by comparison.”

On the same freezing day that he cased the Fed, Mr. Mason gave a tour of the credit union to one of the credit union's founding board members, Kristi Kelly, owner of Good Meds, which grows and sells medical marijuana. Since 2009, when the state started regulating medical marijuana, Ms. Kelly has had 23 bank accounts canceled.

Now Ms. Kelly relies on what she calls the "Bank of Kristi" — the proceeds of Good Meds are kept in a safe and delivered to the tax man, employees, lenders, trade associations and utilities in whatever is discreet and handy, paper bags included.

Touring the credit union, she seemed gleeful. "This is great!" she gushed. "I can't believe how perfect this is." She paused, looking over at an imposing safe with two dial locks on the front. "Is that a bulletproof lock safe? I've written about that in state applications, but I've never seen it!"

Mr. Mason and a lawyer named Martin Kenney, who specializes in fraud law, have put \$600,000 into the management company that organized the credit union, Mr. Mason said. They have recruited nine credit union board members including a local urology surgeon and a Denver city councilman. A local lawyer, Douglas Friednash, who provided the group legal counsel, on Feb. 2 took the post of chief of staff to Gov. John Hickenlooper.

There are 1,200 licensed marijuana businesses in the state, and the credit union expects to get a "significant share," but it cannot sign anyone up until it opens its doors. Its chief obstacle is not financial, but legal. The Controlled Substances Act defines marijuana as a Schedule 1 drug, along with the likes of heroin. It says that these drugs, so easily carried across state lines, can only be controlled through federal oversight. But in 2012, Colorado voters legalized the sale of recreational marijuana by state-licensed businesses, and the state Constitution was amended at the beginning of 2014. Twenty-two other states and the District of Columbia allow some form of legal marijuana. So does federal or state law prevail?

In a 2005 California case, the Supreme Court sided with the federal government. Makers and users of medical marijuana had sought an injunction to prevent federal law enforcement from interfering with their California trade. But the court ruled that federal law prevailed because the business of marijuana in one state could impact supply and demand across state lines.

**To banks, the pre-eminence of federal law has been a powerful deterrent to allowing pot businesses to set up accounts. In fact, Don Childears, chief executive of the Colorado Bankers Association, said his reading of the federal law was that "the very receipt of a deposit is the definition of money laundering." His train of logic: Marijuana is illegal at the federal level; banks that take money from illegal drug operations are guilty of money laundering; therefore, the banks that take pot money face serious criminal and civil liability.**

On Feb. 14, 2014, the Departments of Justice and the Treasury introduced a wrinkle. They each sent out guidelines that seemed to crack open the door for banks to engage with marijuana businesses. The Justice guidelines, known as the "Cole Memo," didn't foreclose the possibility that banks taking marijuana money could be prosecuted for financial crimes, but directed prosecutors to go after significant cases, which it defined using eight priorities. For example, a bank that provided services to a marijuana business that distributed to minors or sold in states where the drug was illegal or used gun violence might be subject to prosecution, but when such aggravating factors were absent, prosecution "may not be appropriate," the guidelines said.

Under the Treasury guidelines, banks are urged to file "suspicious activity reports" when a new pot business opens or closes an account or when such businesses exhibit activities that violate the Cole

guidelines. Treasury characterized the efforts in part as a way to get money into the banking system, where it — and its actors — could be more easily tracked. In sum, the guidance was advertised by many as a “green light” to banks.

**Mr. Childears of the Colorado Bankers Association doesn't see it that way. “They were a yellow light at best,” he said of the guidelines. In fact, he argued, “They raised the liability for the banks.” The costs of filing suspicious activity reports, he said, are considerable and raise all kinds of questions. For example, he asked, what if such a report actually becomes an admission that the bank is participating in an illegal enterprise?**

**Plus, Mr. Childears said, the guidelines are not law. In other words, they don't preclude a federal prosecutor or state attorney general from going after a bank. In fact, two state attorneys general, from Nebraska and Oklahoma, sued the state of Colorado in December, asking that the Colorado law that legalized pot be struck down because it violates federal law and “creates a dangerous gap in the federal drug control program.”**

**Most banks are wary of stepping into this mire, Mr. Childears said, estimating that perhaps 5 percent of Colorado's marijuana businesses use a financial institution (other estimates have put the figure higher, but still below half the pot business in the state).**

Enter the credit union, which state officials see as critical, partly to solve crime and safety risks they see created by all-cash businesses. “It is the first very public marker that this is a place to be banked,” said Andrew Freedman, director of marijuana coordination for Colorado. The credit union, he predicted, will see a surge of business “in a quick amount of time.”

What happens with its application goes to the very fate of the new marijuana industry, argued Chris Myklebust, commissioner of Colorado's division of financial services. If the feds don't grant the application and really open up banking, Mr. Myklebust said, they create a life-threatening chokehold on the businesses, cutting off their ability to profit and survive.

“Without banking,” he said, “the industry is not sustainable in the long run.”

Dylan Donaldson, 30, knows the hidden costs of a bank-challenged business. He has nine 1,000-pound safes bolted to the floor in the back of Karing Kind, the dispensary he owns in North Boulder. At any given time, they hold \$80,000 to \$100,000 in cash.

The safes didn't help, though, when audacious thieves busted through the wall of an adjoining business in the middle of the night in June and took \$250,000 in marijuana plants.

Now he pays \$100,000 a year for armed guards provided by Iron Protection Group, a business owned and operated by vets from Iraq and Afghanistan, who watch the place at night. They also deliver money to the tax office and vendors, from makers of THC concentrate to suppliers of computer paper. At present, the business has no bank account, having lost more than a dozen, Mr. Donaldson said.