

INVESTIGATING THE ROLE OF FINANCIAL INSTITUTIONS IN THE LEGAL CANNABIS INDUSTRY

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NATIONAL CANNABIS INDUSTRY ASSOCIATION
LEGAL AND BANKING COMMITTEE

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National Cannabis Industry Association
TheCannabisIndustry.org

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RATIONALE

The National Cannabis Industry Association (NCIA)'s Legal and Banking Committee was motivated to produce this report following a meeting with California State Treasurer John Chiang and cannabis industry leaders in mid 2017.

NCIA is the leading trade industry association in the legal cannabis space. As “the voice of the cannabis industry,” NCIA members include a diverse array of cannabis businesses and the ancillary businesses that service them, as well as federal, state, and county representatives. With more than 1,400 company members to date, NCIA expects membership to continue expanding in the future, along with the industry itself.

This paper provides a discussion and evaluation of challenges faced by Marijuana Related Businesses (MRBs) operating within the legal cannabis industry, while highlighting some of the benefits the industry brings to financial institutions and the communities they serve.

More specifically, this paper addresses banking, legal, and community issues surrounding MRBs, citing real-life examples and statistics from communities impacted by the legal cannabis industry. Additional topics covered in this paper include best practices, efficiencies, and benefits associated with bringing cannabis to a community and its banks, credit unions, and financial institutions via MRBs. Ultimately, we seek to bring clarification to some of the questions that have arisen from financial industry professionals across the country with a goal to forge a clear path for both the financial industry and the legal cannabis industry going forward.

BACKGROUND ON THE CANNABIS INDUSTRY

In 1996, California became the first state to legalize medical cannabis as more research and empirical evidence supported the medical benefits of cannabis. With the discovery that the human body contains an endocannabinoid system that is set up to receive cannabinoids from the cannabis plant (the same cannabinoids produced by the human body), the promise of cannabis medicine became a game-changer. Over the next 20 years, additional states – as well as countries – came to appreciate the benefits of cannabis, both as a promising substance that advances human health and as a substance that can be regulated and provide tax benefits to the state.

Today, 29 U.S. states plus D.C. and Puerto Rico have legalized the sale of cannabis for medical purposes. Eight of those states -- Alaska, California, Colorado, Maine, Massachusetts, Nevada, Oregon, and Washington -- have passed ballot measures regulating the production and sale of cannabis to *all* adults. (The possession of cannabis is legal for adults in the District of Columbia, but legal, regulated sales do not exist, as Congress has blocked D.C. from implementing regulated sales.)

Despite significant legal changes and advancement of the status of medical and recreational marijuana across the country, banks, credit unions, and financial institutions – along with the municipalities they reside in – have, in many cases, not been adequately informed about the cannabis industry. As a result, critical decisions are being made at municipal, state, and federal levels regarding cannabis without the proper context and accurate information. These decisions are affecting the legal cannabis industry's access to safe banking processes and are leaving MRBs in a state of precariousness in terms of the cash they're bringing in.

Marijuana tax revenue hit \$200 million in Colorado as sales pass \$1 billion

by Trey Williams of *Market Watch*, February 12, 2017

Marijuana sales grew 30% in 2016 and are expected to reach \$20.2 billion by 2021 according to market research

The state of Colorado pulled in nearly \$200 million in tax revenue last year thanks to its \$1.3 billion in marijuana revenue.

The Colorado Department of Revenue announced Thursday the state's revenue had pushed past \$1 billion. Colorado legalized recreational marijuana in 2012, along with Washington state, and this was its third year of regulated sales. In its first year revenue hit \$699.2 million, followed by \$996.2 million the second year.

Overall, U.S. marijuana sales grew 30% in 2016, according to data from Arcview Market Research. And using research from cannabis business intelligence and market research firm BDS Analytics, Arcview forecasts cannabis sales will grow at a compound rate of 25%, from \$6.7 billion in 2016 to \$20.2 billion by 2021.

WHY MRBS NEED FINANCIAL SUPPORT

Marijuana Business Daily estimates in their *Marijuana Business Factbook* that by the end of 2017, the legal marijuana business will grow to represent \$5.1-6.1 billion of revenue across legalized states. By 2021, total legal cannabis sales could reach \$17 billion, with an overall economic impact exceeding \$68 billion dollars.¹ CNBC reported earlier this year that the number of jobs in the legal cannabis industry could surpass that of the manufacturing industry in the nation by 2020.²

The economic growth within the legal marijuana industry extends far beyond just those directly involved in the cultivation and sale of marijuana. Ancillary businesses that provide marketing services, real estate services, edibles manufacturing, extraction services, or legal services, to name a few, have a lot to benefit from within the cannabis industry. In order to grow and maintain effective financial processes, these ancillary businesses require the services of

¹ <https://mjbizdaily.com/wp-content/uploads/2017/05/Factbook2017ExecutiveSummary.pdf>

² <https://www.cnbc.com/2017/04/20/5-high-paying-marijuana-jobs-in-the-legal-cannabis-industry.html>

banks, credit unions, and financial institutions as well and shouldn't be discriminated against for their affiliation with MRBs.

Simply put, there is a lot of money to be held within the cannabis industry. Having giant stashes of cash in a high-revenue industry increases the risk of violent crimes for dispensaries and cultivators, essentially making them a prime target for theft. This poses a public threat that must be addressed. In addition to safety issues, dispensary and cultivation employees need to be paid and investor money needs to be secured. These transactions need to be sound and secure – just as any with any business: large-scale cannabis businesses can't operate as cash-only businesses.

COMMUNITY IMPACTS OF THE CANNABIS INDUSTRY

The legalization of cannabis on both medical and adult-use fronts have brought about both positive and negative social and economic changes in those states. Despite this, the forces of the legalized cannabis movement in states show no sign of stopping, making it logical for banks, credit unions and financial institutions to provide the necessary financial service.

SOCIO-ECONOMIC GROWTH

Municipalities and states that have legalized either medical or recreational cannabis, or both, report positive socio-economic benefits as a result of the tax revenues from cannabis sales, with a boost in economic gains from cannabis in the millions (with Colorado and Washington leading the charge). Although strict restrictions in legal states surrounding the use of cannabis may dissuade investors, potentially halting cash flow into certain areas, legalized states report major socio-economic benefits to the addition of the cannabis industry.

A well-respected Colorado cannabis publication associated with *The Denver Post* called *The Cannabist* reported the final revenue figures for Colorado in 2016 to be \$1.3 billion, up from \$996.2 million the previous year³.

According to *The Washington Times*, dispensaries in Washington have now topped \$1 billion in sales of medical cannabis since 2012 – with legal sales of adult use cannabis beginning in 2014 – with no signs of a decrease in sales happening anytime soon⁴.

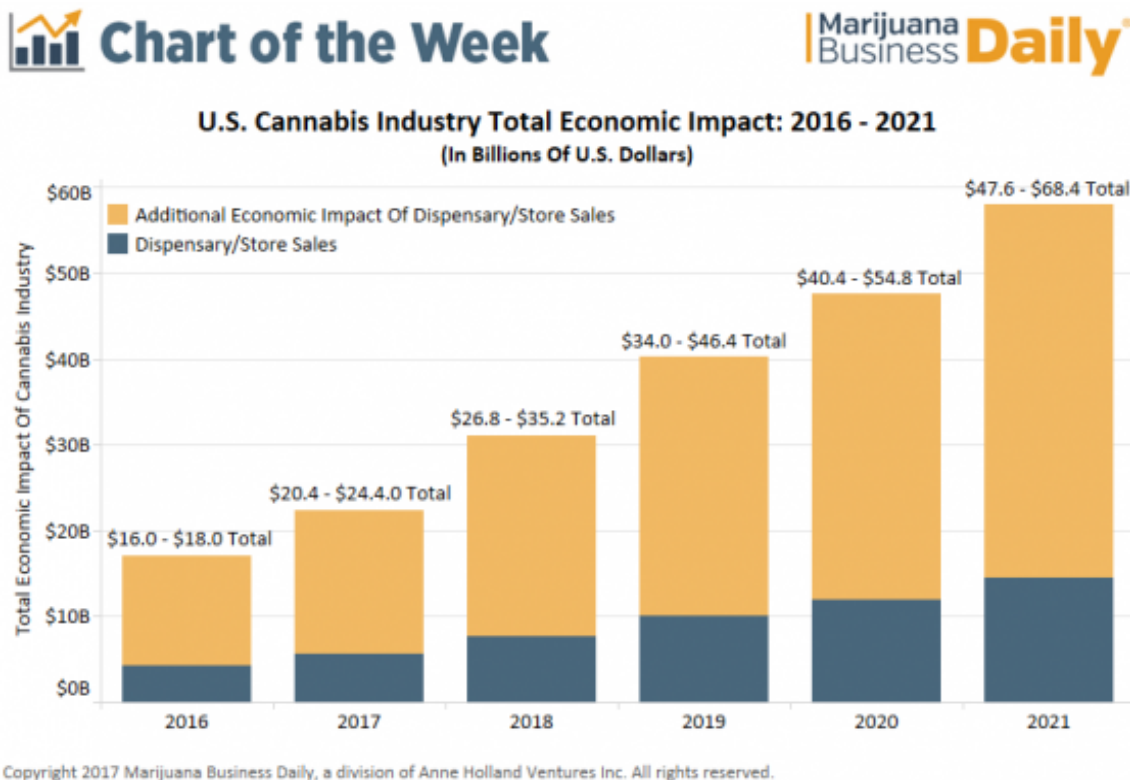
Although adult use cannabis will not be implemented until 2018 in California, economic analysts are enthusiastic about the potential for economic impact from recreational sales on the

³ <http://www.thecannabist.co/2017/02/09/colorado-marijuana-sales-2016/73415/>

⁴ <http://www.washingtontimes.com/news/2016/jul/8/marijuana-sales-washington-top-1-billion-report/>

state. According to New Frontier Data, the cannabis market in California is expected to swell to an estimated \$6.5 billion by 2020⁵.

U.S. CANNABIS INDUSTRY'S ECONOMIC IMPACT TO APPROACH \$70B BY 2021



The promise of economic benefits will be alluring to states and financial institutions who are eager to benefit from legal marijuana sales by MRBs. As such, banks, credit unions, and financial institutions will be willing to follow the prescribed guidelines by FinCEN, Cole Memo II, and other regulatory guidelines while maintaining the flexibility required to provide relevant and profitable services to the cannabis industry.

A further analysis of the socio-economic impact of the marijuana industry will shed more light on how much ground the industry is gaining thereby giving financial institutions more insight as to why they need to invest their time, money, and services in the industry.

CRIME REDUCTION

Legalization of cannabis has been gaining ground in the United States due to its proven ability to reduce drug-related crime in legalized states, including the illegal sale of drugs to

⁵ <https://newfrontierdata.com/wp-content/uploads/2015/11/California-State-Profile-Release-FINAL.pdf>

minors or the fraudulent sale of regulated substances. A concern over the protection of minors continues to persist, yet data show declines in adolescent cannabis consumption in recent years⁶; compliance checks with regard to illegal sales to minors seem to be an effective enforcer of sticking to the rules of access.

Unfortunately, even in legalized states, people of color are more likely to become a victim of drug-related arrests. For instance, it was found in Colorado and reported by *The Guardian* shortly after recreational sales in the state began that black people were 2.5 more times likely to be targeted for cannabis-related offenses (which still exists).⁷

States that have legalized cannabis have placed stringent monitoring strategies on MRBs and other firms dealing with cannabis or cannabis revenue so as to have the industry operate in line with the law. Figures from the Drug Policy Alliance indicate that the legalization of the sale of recreational cannabis in Colorado brought about a 2.2 percent drop in the rate of violent crimes and an 8.9 percent drop in overall property crime in Denver the following year⁸. The same source further indicated that violent crime waves in Washington dropped by 10 percent between 2011 and 2014; legalization of recreational cannabis sales began in the state in 2012.

INCREASED PROPERTY VALUES

The legalization of cannabis in some states led to an increase in housing costs due to an influx of people looking to benefit from cannabis legalization either as a business opportunity or personally. In areas where cannabis use is legalized and the cost of housing has increased, the cost of living has gone up as well, leading to the gentrification of neighborhoods and possible displacement of existing communities who can't keep up with cost of living increases. Based on information obtained from *Forbes'* Case-Shiller Home Price Index for Denver, Seattle, and Portland, real estate investors experienced an economic boom with home prices in all three cities rising steadily since 2012⁹.

The increase in housing prices in areas with legal cannabis indicate an opportunity for banks, credit unions, and financial institutions to extend their services to their core clients in industries who have experienced growth in their businesses due to MRBs and legalization.

EMPLOYMENT GROWTH

In a country that is focused on job creation, MRBs represent a strong infusion of employment opportunities into the employment sector, with 165,000-230,000 full-time and part-

⁶ <http://www.washingtonexaminer.com/teen-pot-use-hits-new-low-amid-turmoil-for-legalization-backers/article/2633750>

⁷ <https://www.theguardian.com/us-news/2015/mar/25/colorado-marijuana-legalization-racial-disparity-drug-arrests>

⁸ <https://coloradopolitics.com/despite-claims-data-show-legalized-marijuana-not-increased-crime-rates/>

⁹ <https://www.forbes.com/sites/erincarlyle/2016/03/29/home-prices-rise-a-steady-5-4-in-january-spcase-shiller-says/#6444a2f53c64>

time workers, including “plant touching” workers (direct) and ancillary services (indirect). *Marijuana Business Daily’s* factbook for 2017 reports that in the United States, there are more people employed in the cannabis industry than there are dental hygienists or massage therapists. Given these statistics – including the earlier information that projected jobs in cannabis will surpass those of manufacturing by 2020 – and it’s evident why MRBs need a supportive financial system through which to pay their employees legally.

TAX REVENUES

The marijuana industry generates taxes both directly and indirectly. According to *Business Insider*, the state of California itself has a substantial amount of money to earn from the legalization of cannabis due to the two specific taxes (a cultivation and a retail tax) that will be required as a result of Proposition 64. With the regulated sale of cannabis, municipalities can also impose additional taxes known as “special taxes” or offer tax-free benefits in order to encourage the growth of the legal cannabis industry.

Where exactly do cannabis state taxes go? In Colorado, *Entrepreneur* reports that for 2016-2017, \$40 million annually goes to building schools; \$18 million goes to public health and marijuana education; \$8.4 million goes to improving literacy, graduation rates, and anti-bullying programs; \$3 million goes to agriculture for pesticide control and inspections; and the offices of the Attorney General and Governor receive some hundreds of thousands of dollars to put towards their legalization and enforcement efforts¹⁰.

These numbers alone should provide incentive and evidence of the high degree of community value that cannabis tax dollars provide.

INDUSTRY CASE STUDIES

Briefcases and Backpacks Full of Cash: Safe Harbor’s Solution

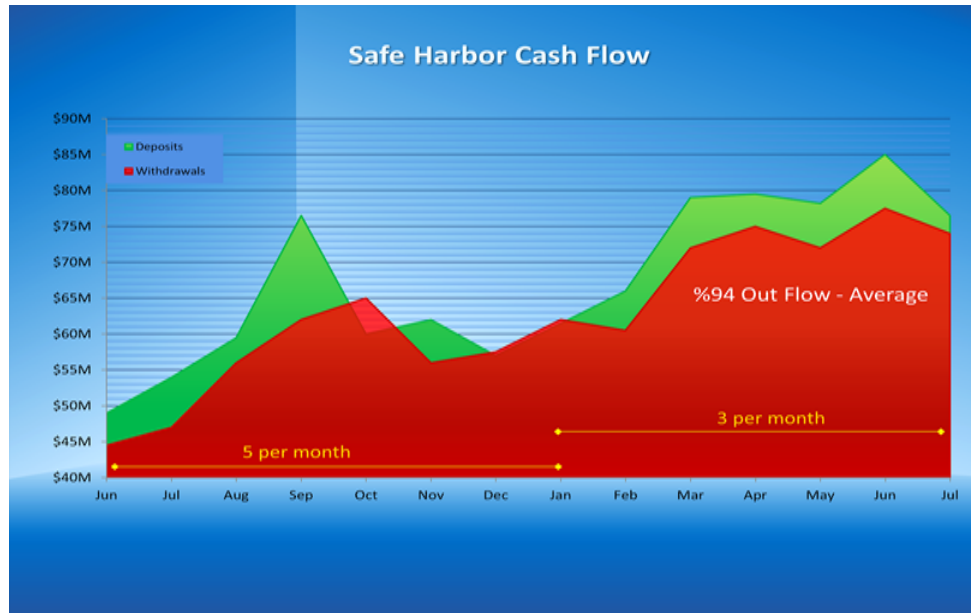
by CEO Sundie Seefried, posted on Safe Harbor Private Banking’s website, May 2, 2017¹¹

Last month alone, the Safe Harbor team took deposits of nearly \$80 million off the streets and out of neighborhoods in Colorado. Altogether, we’ve banked over \$1 billion to date for cannabis related entities. Our team diligently validates every dollar, and strictly reports and monitors transactions, according to FinCEN guidelines. Recently, we were asked why we have to limit the number of new clients we take on. Due to the fast growth of the program, we’ve adjusted new business onboarding from five clients per month to three, because it’s necessary to maintain balanced growth between the Safe Harbor commercial division and our consumer base. And, because we are a compliance-based program, we responsibly work within our safety and soundness limitations. With the legalization of marijuana in Colorado, an industry was born into a situation of legal conflict between state and federal laws, which left the industry without banking privileges. This provided the

¹⁰ <https://www.entrepreneur.com/article/289613>

¹¹ <https://safeharborprivatebanking.com/>

credit union with a unique opportunity to serve the needs of struggling businesses while making the community safer. We remain committed to our cannabis business clients and will continue to offer them support, safety and stability in this ever-changing marketplace.



Canndescent is a cannabis cultivation company that has recently secured the support of a credit union in California. But it was not easy. The company spent more than four months being examined before being permitted to be served by the credit union. A recent feature in the *Los Angeles Times* explained that Canndescent takes a direct and transparent route into the financial system by depositing its cash payments to a downtown Los Angeles branch of the Federal Reserve Bank¹².

The first company to be operational in Desert Hot Springs, California, Canndescent has led the way in the cannabis industry with excellent banking practices. MRBs have been tuned into Canndescent's progress with a desire to replicate the success of their financial accomplishments as the company evolves in terms of its banking processes and community acceptance since they started up.

¹² <http://www.latimes.com/business/la-fi-cannabis-banking-20170707-story.html>

Q&A with Carmella Houston, VP of Business Services, Salal Credit Union, NCUA-insured, with 6 branches in Washington state

Q: What made you decide to bank the cannabis industry?

A: After the passing of I-502 in 2012, we saw this as a chance to help make our communities safer by removing large amounts of cash from the streets.

Q: How did you approach the Board of Directors/executive team?

A: We are lucky to have a board of directors who are open to new ideas. We started as a credit union for the healthcare industry, and our board saw this as an opportunity to further the research of the potential health aspects of cannabis. By banking the industry and providing a safe place for cash to be kept, we helped to facilitate safer businesses and neighborhoods. And at the same time, we committed to doing so with a positive ROI to our members.

Q: What obstacles have you run into?

A: During the initial inspection of our program, our federal regulators were not onboard. The issue was less of whether or not we were following the proper guidelines, and more so whether or not cannabis should be legal. Thanks to the speedy help of our Governor and congressional representatives, we were able to address the open items the inspectors had at that time and proceed forward.

Q: What qualifiers are in place for each business to gain a checking account?

A: First and foremost, the business must be properly licensed and in good standing to be able to open an account. In addition, we expect account holders to have a sound financial understanding of their business. We allocate a significant amount of resources to onboarding new accounts, so we look for business owners with a solid plan for success.

Q: How extensive is your due diligence program?

A: We take due diligence very seriously. We complete a thorough review of each business owner's credit, background, and financial ability to maintain and grow the business. We examine the business, its owners, and even the investors.

Q: Do you use a 3rd party source to assist with due diligence?

A: No, all of our due diligence and compliance teams are internal. We feel it is an important part of the FINCEN guidance of knowing your customer/member.

Q: Are your bankers required to be BSA/ALM certified?

A: Yes, our bankers pass all BSA requirements. As well as continuing learning activities.

Q: What concerns do you have banking the industry moving forward?

A: We continue to have a very positive outlook on the industry. And even more so with the legalization of adult-use cannabis in more states.

THE CURRENT STATE OF CANNABIS AND BANKING LAW

The incorporation of the February 2014 Financial Crimes Enforcement Network (FinCEN) guidance related to banking MRBs has been announced by each of the federal bank agencies, including the Federal Reserve Banks that have stated that they will also follow the new FinCEN guidelines when dealing with financial institutions providing banking services to MRBs.¹³

To accommodate the growing number of states adopting medical and recreational marijuana legalization, several state banking departments have put forth specific guidelines for their state-chartered banks and credit unions to follow when providing services to MRBs. Joint projects are also underway by state industry associations for banks and credit unions whose goal

¹³ [US Dept of Treasury FinCen guidelines](#), February 11, 2014.

is to facilitate the implementation of banking services to the cannabis industry. Despite promising and progressive regulatory and policy revisions, operating guidelines, and FinCEN rulings for banks working with MRBs, the majority of financial institutions have not embraced moving forward with providing services to the cannabis industry.

Financial institutions cite several reasons for their decision, some of which include:

- Concerns about violating federal law, under which cannabis remains a Schedule 1 illegal substance;
- Fear of a reputational risk if a firm is seen to be in breach of federal law, even with sufficient evidence of clients needing a safe and legal way to bank; and
- Difficulty and high cost of resources for implementing compliance programs within their financial institutions.

Banking the Cannabis Industry: Takeaways from the California Cannabis Banking Working Group

Excerpts from article by Fiona Ma, CPA, of the California State Board of Equalization Assembly, *Cannabis Business Executive*, August 17, 2017¹⁴

The countdown to launch the largest new market for recreational sales in the cannabis industry is almost here and the state of California still doesn't have an answer to the million dollar question – "How do we bank the cannabis industry?"

Without access to banks, this industry struggles with safety – transporting large amounts of cash to pay taxes, fees, licenses, employees, and other normal operating costs, sometimes traveling and transporting the money great distances. There is the continued need for accountability – keeping accurate records of sales and products to satisfy regulators.

And the challenge regarding business management? Think about it – in an increasingly digital society with credit cards, online shopping, and making payments on a mobile phone, when is the last time you carried cash in your pocket? I've been honored to lend my expertise to California State Treasurer John Chiang's Cannabis Banking Working Group, meeting around the state hearing from experts and the public, to find workable solutions to the challenges facing this industry.

While California has been a leader in the cannabis industry for several years, other states are now doing their part to ensure these businesses are able to contribute to their economy like any other business model. Oregon, for example, just passed landmark cannabis legislation last year to exempt any bank or credit unions from any state liability for conducting financial services for legal, state-regulated cannabis businesses.

ACKNOWLEDGING THOSE SERVING MRBs

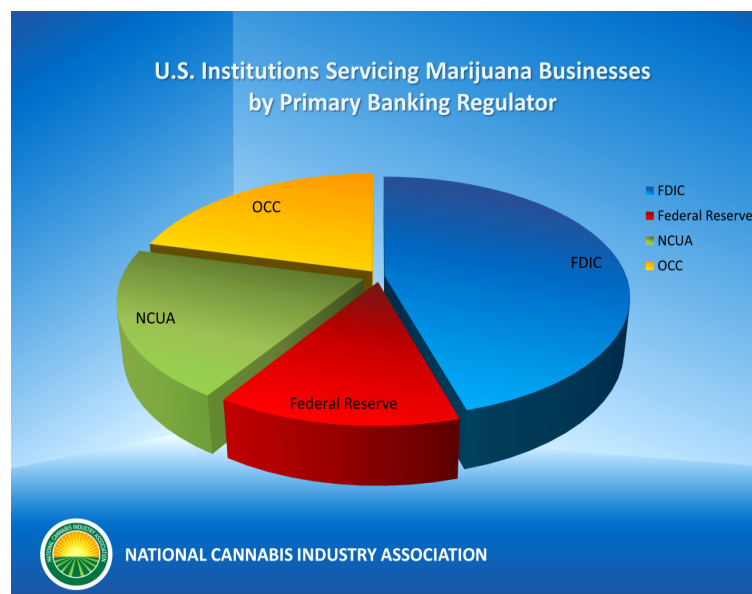
It must be acknowledged that despite the reluctance of many banks, credit unions, and financial institutions to provide services to the marijuana industry, some have been doing so, as

¹⁴ [Cannabis Business Executive](#), August 18, 2017. Fiona Ma represents close to 10 million people in 23 counties from the Oregon border to Santa Barbara County. The 5,000 person tax agency affects every taxpayer in California and has broad regulatory and adjudicatory powers and is the only elected tax board in America.

the Cannndescent example demonstrates. In fact, according to public information from FinCEN, which receives information from financial institutions that report to them in accordance with Department of Justice guidelines (to be discussed further in this paper), FinCEN memoranda, and SAR reporting, more than 300 financial institutions currently provide services to the marijuana industry¹⁵. In addition, over the last year alone, there has been a 100-percent increase in the number of financial institutions engaged in providing financial services to MRBs.

By providing these services, banks, credit unions, and financial institutions have experienced significant increases in business opportunities around deposits, lending, and other banking-related services. One such example is Timberland Bank in Washington State, which included a disclosure in its public filings that its demand deposits and related net interest margin have increased significantly as a result of its decision to provide banking services to MRBs in that state.

We have seen that these financial institutions have sourced solutions to assist in compliance and technological requirements for serving MRBs while continuing to have examinations by bank regulatory agencies. Despite these reviews, banks have yet to experience negative public action for sourcing MRB-related solutions, perhaps due to the profits these regulatory agencies are observing. This is illustrative of the high degree of professionalism within the cannabis industry and the willingness for MRBs to comply with legal requirements in order to continue profiting from the cannabis industry.



¹⁵ https://www.fincen.gov/sites/default/files/shared/Marijuana_Banking_Update_Through_Q1_2017.pdf

FEDERAL PRIORITIES

On one hand, it is the duty of a federal government to protect its citizens, especially minors, from the dangers associated with exposure to cannabis or other substances at an early age. The federal government is also concerned about any careless or wrongful use of cannabis that could increase violence-related crimes or the illegal trafficking of other drugs in the country. On the other hand, the federal government recognizes the legal cannabis industry as a source of tax revenue and employment for the states in which they operate. In an attempt to provide options for states while also protecting all citizens of the United States, the Department of Justice outlined eight federal priorities that would guide their marijuana enforcement activities. Contained within what is known as *The Cole Memo* – named after former U.S. Deputy Attorney General James Cole, who issued the memo during his tenure – the priorities are:

- ❖ Preventing the distribution of marijuana to minors;
- ❖ Preventing revenue from the sale of marijuana from going to criminal enterprises;
- ❖ Preventing the diversion of marijuana from states where it is legal under State law in some form to other states (transportation of product between state lines);
- ❖ Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- ❖ Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- ❖ Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- ❖ Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- ❖ Preventing marijuana possession or use on federal property.

These guidelines set forth the proposition that if state law is consistent with the federal priorities and is effectively enforced, the Department of Justice (DOJ) will defer enforcement activities to the state authorities.

COLE MEMO II

The second Cole Memo, issued in February 2014, reiterated the DOJ's position that it will focus its attention on the priorities outlined in the first Cole Memo. But it went further to explain that these same priorities would apply when financial institutions provide banking services to

MRBs. Accordingly, financial institutions banking MRBs are assumed to be responsible for monitoring the activity of their customers to ensure that they are acting in compliance with state cannabis laws.

Cole Memo II suggests a few ways through which financial institutions, banks, and credit unions can effectively provide services to MRBs and subsequently increase profits. According to Cole Memo II, financial institutions must continue to apply appropriate risk-based, anti-money laundering policies, procedures, and controls that are sufficient to address the perceived risks posed by MRBs customers.

For example, financial institutions can include due diligence processes that identify potential clients that are not adhering to any of the eight federal priorities or FinCEN's guidelines. This proposition by Cole Memo II suggests that a financial institution may provide banking services to an MRB through compliance with the guidelines outlined in the Cole Memorandums and by FinCEN.

Banking and the Marijuana Industry¹⁶

By Priya Roy & Brian N. Kearney of *Money Laundering Watchdog*, July 11, 2017

Last month, FinCEN issued an update on Marijuana-Related Business with data from 2017 Q1. The report indicates that the number of depository institutions (banks and credit unions) actively providing banking services for marijuana-related businesses has increased from 285 in January 2016 to 368 in March 2017. Since the 2014 FinCEN memo outlining mandatory filings of SARs for such businesses, FinCEN has received over 28,000 such reports. In the first quarter of 2017, specifically, filings of "Marijuana Limited" SARs increased significantly, while "Marijuana Priority" and "Marijuana Termination" filings stayed relatively static. This suggests that, while more banks are taking on marijuana-related businesses as customers there is not a corresponding increase in the amount of (observed) suspicious activity.

DEPARTMENT OF THE TREASURY GUIDELINES

The Department of the Treasury through FinCEN has set up a platform through which suspicious activities observed by financial institutions providing services to the marijuana industry can be tracked. For example, the 2014 FinCEN guidance provides a framework for Suspicious Activity Reports (SAR) and suggestions for enhanced and ongoing due diligence processes along with the regularly-required active compliance testing for specified 'red flags.'

The key elements of the new FinCEN guidelines for financial institutions providing services to MRBs include:

- ❖ The financial institution must determine whether its MRB customer complies with applicable state law;

¹⁶<https://www.moneylaunderingwatchblog.com/2017/07/continued-and-unexpected-roadblocks-to-serving-mrbs-fourth-corner-credit-union-v-federal-reserve-bank/>

- ❖ The financial institution must conduct appropriate initial and ongoing due diligence of all cannabis-related customers to be assured the MRB customer is operating according to state laws, and that such conduct does not violate any of the eight key principles enumerated in Cole Memo I;
- ❖ The financial institution must develop an expected activity for the business, including the type of products, the expected volumes of sales of the products, and the type of customers to which products are sold;
- ❖ The financial institution must file SAR's as appropriate;
- ❖ The financial institution's compliance assessments must include consideration of eleven stated 'red flags;'
- ❖ The financial institution must collect and perform analysis of all MRB financial transactions to assure that revenues are legally obtained and legally expended.

Following the release of the FinCEN Guidelines in February 2014, federal bank regulatory agencies adopted the guidelines in carrying out their supervisory duties and examinations of financial institutions¹⁷.

Credit Unions, Banks Warily Watch Jeff Sessions on Marijuana Policy

By Cheryl Miller of *Credit Union Times*, August 1, 2017¹⁸

U.S. Attorney General Jeff Sessions has loomed as a threat to the legalized marijuana industry. But Sessions, at the helm of the U.S. Justice Department since February, hasn't taken any overt action to undermine state regulations, giving some hope to cannabis advocates that the longtime critic of recreational cannabis will not interfere in state schemes.

Addressing the Cannabis Law Institute conference in Denver, [former U.S. Justice Department official John] Vardaman said Sessions had the opportunity to launch a crackdown on July 27. But Sessions did not make any grand statements. That date marked when a Sessions-appointed task force was expected to issue a report recommending changes to DOJ policies, including those covering marijuana. Sessions said he would consider the task force's recommendations as they arrived on a "rolling basis."

"If the department had really wanted to rescind the Cole memo and the U.S. Treasury Department's Financial Crimes Enforcement Network memo they could have easily done that," Vardaman said, referring to Obama administration guidance for banks and regulators in marijuana-legal states. "They chose not to," Vardaman continued, "and I think at a minimum that's a reflection of the fact that this is a more complex issue than they may have assumed when they entered office." Vardaman, who co-wrote a follow-up to the Cole memo in 2014, said he met with Sessions' task force leaders earlier in July."

¹⁷ The adoption is evidenced by the June 27, 2014 FDIC letter addressed to the Washington State Department of Financial Institutions and the August 13, 2014 Interagency Letter to the Governor of Washington State. Further, as is reflected in FIL 5-2015, it is not FDIC policy to 'redline' any industry although it encourages financial institutions to provide services to any industry sector on the basis of the financial institution's risk assessment.

¹⁸ <http://www.cutimes.com/2017/08/01/credit-unions-banks-warily-watch-jeff-sessions-on>

Though the Cole memo and Fincen guidance are in place, for now, banks have not rushed to welcome marijuana businesses as customers. Just 300 or so credit unions and mostly small banks openly serve industry clients in the 29 states and Washington, D.C., where recreational or medical use is legal.

RECOMMENDATIONS FOR BANKING WITH MARIJUANA RELATED BUSINESSES IN THE LEGAL CANNABIS INDUSTRY

Below, we provide answers to some frequently asked questions about the potential relationship between banks, credit unions, and financial institutions with MRBs. This base of knowledge will serve to inform financial institutions about banking with the legal cannabis industry:

1. What are the required components of an adequate MRB compliance system that would be used by banks, credit unions, or financial institutions?

The required components of an adequate MRB compliance system include but are not limited to the following:

- ❖ Formal client risk assessment with appropriate background checks and or risk profile development;
- ❖ Adequate support from bank executives for MRBs, recognizing it may take months to implement systems that vet clients based on their value, and are not enabling the illegal transfer of funds;
- ❖ Proper policies and procedures that adhere to certain MRB guidelines;
- ❖ Regular manual compliance adjustments with the possibility of implementing a system to manage progress;
- ❖ BSA monitoring and reporting systems that engage in ‘red flag’ reporting and auditing.

2. How have banks, credit unions, and financial institutions successfully moved forward with MRB clients?

To move forward strategically, a bank or financial institution considering offering services to MRBs should consider:

- ❖ Their degree of reputational risk, which will determine whether services to MRBs will be a public or private offering;
- ❖ A slow implementation of taking on MRB clients that includes:
 - Limiting the number of MRB clients in scope and specific services;
 - Limiting the number of MRB clients in a one-year pilot project, for example, by opening accounts for only one or two MRB’s within the first year;

- A complete one-year audit and marking of milestones at the end of the year.

3. What are the noted benefits of the aforementioned strategies as reported by legalized states?

Financial institutions in states that have used limited implementation strategies like those mentioned above to support MRBs report:

- ❖ Proactive management of MRB accounts, ensuring issues are addressed as they arise and systems are enhanced to improve the services provided to future clients;
- ❖ More effective reviews for auditors when economic impacts of MRBs on financial institutions are limited;
- ❖ The ability to effectively scale down and manage pilots when firms have decided to discontinue services;
- ❖ Alignment and validation of capital planning for the increased revenue, transactions, and other procedures that will be provided by MRBs.

4. How can financial institutions set up the required infrastructures to deal with the influx of deposits?

The financial institution may need to establish correspondent relationships with other receiving financial institutions that are willing to accept excess deposits. This can be achieved by establishing off-balance sheet sweep accounts with accepting institutions such as a trust company.

The financial institution plan should specify how to increase the Net Interest Margin and relate profitability from the increased deposit balances. Banks have consistently reported increases when opening accounts in the cannabis space. These increases should be tracked from the implementation of the project to justify further expansion.

CONCLUSION

The cannabis industry is a multi-billion dollar industry that appears poised for continued growth into the future. The federal government, appreciating the vast sums of money involved, has provided to financial institutions a pathway through which they can provide services to MRBs. A logical action for banks, credit unions, and other financial institutions would be to extend current services to marijuana-related businesses that are demonstrably acting in compliance with required state laws. These institutions will not only enhance public safety by providing these services, but they will also increase their revenues by offering accounts and lending to the cannabis industry.

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*The opinions and views expressed in this white paper are the committee's own and do not reflect the view of National Cannabis Industry Association.