Date of Hearing:

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
AB 1575 (Bonta) – As Amended April 13, 2016

SUBJECT: Medical cannabis

SUMMARY: Makes changes to the Medical Marijuana Regulation and Safety Act (MMRSA) Specifically, **this bill**:

1) Renames MMRSA to the Medical Cannabis Regulation and Safety Act (Act).

2) Requires the State Board of Equalization (BOE) to form an advisory group made up of representatives from financial institutions, the medical cannabis industry, law enforcement, and state and federal banking regulators.

3) Mandates the BOE to submit a report to the Legislature by July 1, 2017 with proposed changes to state law or regulations that will improve financial monitoring of medical cannabis and improve compliance with federal law.

4) Requires The Department of Business Oversight (DBO) to create an enhanced financial monitoring certification for entities licensed pursuant to the Act that further enables those entities to comply with the federal banking regulations under the federal Bank Secrecy Act (BSA). Further requires DBO to consider including requirements to use electronic financial monitoring that enables real-time sales inventory tracking and other tools that allow a bank or credit union to readily access information they are required to monitor under the federal BSA.

5) Allows DBO to collect fees from applicants requesting the enhanced financial monitoring certification in an amount sufficient to fund the actual reasonable costs of implementation.

6) Specifies that a financial institution that provides financial services to a licensee under the Act is exempt from any criminal law of this state, provided that the financial institution has verified the licensee has a valid license in good standing.

7) Makes numerous other changes to MMRSA.

EXISTING STATE LAW:

1) Prohibits the possession, possession with intent to sell, cultivation, sale, transportation, importation, or furnishing of marijuana, except as otherwise provided by law. (Health and Safety Code (HSC) §§ 11357, 11358, 11359, and 11360)

2) Prohibits prosecution of a patient or a patient's primary caregiver for possessing or cultivating marijuana for personal medical purposes of the patient upon the written or oral recommendation or approval of a physician. (HSC § 11362.5)

3) Provides that qualified patients, persons with valid identification cards, and their designated primary caregivers who associate in order to collectively or cooperatively cultivate

marijuana, are not subject to criminal liability solely on that basis, until one year after the Bureau of Medical Marijuana Regulation (Bureau) begins issuing licenses under the ACT. (HSC § 11362.775)

4) Enacts the Act, which provides for the state licensure and regulation of commercial cannabis activities, including cultivation, possession, manufacture, processing, storing, laboratory testing, labeling, transporting, distribution, and sale of medical cannabis or medical cannabis products. (Business and Professions Code (BPC) § 19300 *et seq*.)

5) Establishes the Bureau within the Department of Consumer Affairs (DCA), and requires the Bureau, the California Department of Public Health (CDPH), and the California Department of Food and Agriculture (CDFA) to administer the Act and promulgate regulations for implementation of the act. (BPC § 19300 *et seq*.)

6) Vests in the DCA the sole authority to create, issue, renew, discipline, suspend, or revoke licenses for medical marijuana activities, including licenses for dispensaries, distributors, and transporters. Prohibits a licensee from holding more than one license except as specified. (BPC §§ 19302.1, 19328)

7) Allows the Bureau to convene an advisory committee to advise the Bureau and licensing authorities on the development of standards and regulations, including best practices and guidelines to ensure qualified patients have adequate access to medical marijuana and medical marijuana products. (BPC § 19306)

8) Provides that the actions of a licensee permitted pursuant to both a state license and a license or permit issued by the local jurisdiction following the requirements of the applicable local ordinances, and conducted in accordance with the Act are not unlawful under state law. (BPC § 19317)

9) Prohibits a person from engaging in commercial cannabis activity without possessing both a state license and a local permit or other authorization upon the date of implementation of regulations by the licensing authority. (BPC § 19320)

10) Requires an applicant for a state license to, among other things, submit fingerprints to the Department of Justice, and provide documentation, issued by the local jurisdiction, certifying that the applicant is in compliance with all local ordinances and regulations; evidence of the legal right to occupy the proposed location; for applicants with 20 or more employees, provide a statement that the applicant will enter into, or already has entered into, a labor peace agreement; a seller's permit number; and other specified information. (BPC § 19322)

11) Requires applicants seeking licensure to cultivate, distribute, or manufacture medical cannabis, to include a detailed description of the applicant's operating procedures for all of the following as required by the licensing authority: 1) cultivation; 2) extraction and infusion methods; 3) transportation procedures; 4) inventory procedures; and 5) quality control procedures. (BPC § 19322)

EXISTING FEDERAL LAW

The Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act of 1970 (31 U.S.C. 5311 et seq.) is referred to as the BSA. The purpose of the BSA is to require U.S.

financial institutions to maintain appropriate records and file certain reports involving currency transactions and a financial institution's customer relationships. Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs) are the primary means used by banks to satisfy the requirements of the BSA. The recordkeeping regulations also include the requirement that a financial institution's records be sufficient to enable transactions and activity in customer accounts to be reconstructed if necessary. In doing so, a paper and audit trail is maintained. These records and reports have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.

The BSA consists of two parts: Title I Financial Recordkeeping and Title II Reports of Currency and Foreign Transactions. Title I authorizes the Secretary of the Department of the Treasury (Treasury) to issue regulations, which require insured financial institutions to maintain certain records. Title II directed the Treasury to prescribe regulations governing the reporting of certain transactions by and through financial institutions in excess of $10,000 into, out of, and within the U.S.

The Treasury's implementing regulations under the BSA are included in the FDIC's Rules and Regulations and on the FDIC website. The implementing regulations under the BSA were originally intended to aid investigations into an array of criminal activities, from income tax evasion to money laundering. In recent years, the reports and records prescribed by the BSA have also been utilized as tools for investigating individuals suspected of engaging in illegal drug and terrorist financing activities. Several acts and regulations expanding and strengthening the scope and enforcement of the BSA, anti-money laundering (AML) measures, and counter-terrorist financing measures have been signed into law and issued, respectively, over the past several decades. Several of these acts include:

1) Money Laundering Control Act of 1986

2) Annuzio-Wylie Anti-Money Laundering Act of 1992

3) Money Laundering Suppression Act of 1994

4) Money Laundering and Financial Crimes Strategy Act of 1998.

Most recently, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (more commonly known as the USA PATRIOT Act) was enacted by Congress in October 2001, in response to the September 11, 2001 terrorist attacks. The USA PATRIOT Act established a host of new measures to prevent, detect, and prosecute those involved in money laundering and terrorist financing

The Controlled Substances Act (CSA) (21 U.S. Code § 812)is the federal drug policy that regulates the manufacture and distribution of controlled substances such as hallucinogens, narcotics, depressants, and stimulants. The CSA categorizes drugs into five "Schedules" or classifications based on their potential for abuse, status in international treaties, and any medical benefits they may provide. Drugs classified in Schedule 1 are considered the most harmful substances with no medical benefits, and the rest descend from there. Marijuana is listed as a Schedule 1 drug.

FISCAL EFFECT: Unknown

COMMENTS: AB 1575 makes numerous changes to the current regulatory scheme for medical cannabis. The Assembly Business and Professions Committee recently heard this bill and examined the various changes impacting areas under the jurisdiction of that committee. This analysis will focus on those items in AB 1575 that impact banking and finance issues.

AB 1575 would do four key things around the issue of banking medical cannibas businesses (MCBs)

1) Advisory Group: BOE would form an advisory group made up of representatives from financial institutions, the medical cannabis industry, law enforcement, and state and federal banking regulators.

2) Reporting: BOE is required to submit a report to the Legislature by July 1, 2017 with proposed changes to state law or regulations that will improve financial monitoring of medical cannabis and improve compliance with federal law.

3) Creation of special monitoring certification: Requires DBO to create an enhanced financial monitoring certification for entities licensed pursuant to the Act that further enables those entities to comply with the federal banking regulations under the federal BSA. Further requires DBO to consider including requirements to use electronic financial monitoring that enables real-time sales inventory tracking and other tools that allow a bank or credit union to readily access information they are required to monitor under the federal BSA.

4) Protection of criminal Liability: A financial institution that provides financial services to a licensee under the Act would be exempt from any criminal law of this state.

An obstacle faced by those operating MCBs in California is the lack of banking services. Businesses ranging from dispensaries to growers all operating within California's legal framework have faced the closure of bank accounts or denial of new accounts. This has led to fees and taxes being paid at government offices with large bags of cash that only raise further suspicion or create security concerns.

On February 14, 2014 the FinCEN issued guidance (FIC-2014-G001) to clarify BSA expectations for financial institutions seeking to provide services to cannabis-related businesses. Financial institutions and those in the legal cannabis business hoped that the guidance would provide greater clarity and potentially open up more financial institutions for access. Unfortunately, the guidance only added further confusion and did little to eliminate the risk faced by financial institutions.

Banks are required to file SARs when they think that a transaction might have an illegal connection such as drug trafficking. Rather than clarify the existing SAR process for legal cannabis businesses the new guidance outlines three tiers of SARs to use just for cannabis businesses: “cannabis limited,” “cannabis priority,” and “cannabis termination.” In spite of expanding paperwork requirements FinCEN was quoted in the press as saying that these changes would reduce the burden on banks. Almost two years after the issuance of this guidance, financial institutions are still hesitant to open accounts for legal cannabis businesses whether they are in California or other states that have legal medical or recreational cannabis.

The current federal enforcement policy concerning state legalized cannabis activity is contained in the Cole memo. This memo provides guidance to federal enforcement authorities giving the status of cannabis as legal for medical or recreational use in several states. The Cole memo illuminates how federal prosecutorial resources will be focused on the issue of cannabis by providing the following enforcement priorities:

1) Preventing the distribution of cannabis to minors;

2) Preventing revenue from the sale of cannabis from going to criminal enterprises, gangs, and cartels;

3) Preventing the diversion of cannabis from states where it is legal under state law in some form to other states;

4) Preventing state-authorized cannabis 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 cannabis;

6) Preventing drugged driving and the exacerbation of other adverse public health consequences associated with cannabis use;

7) Preventing the growing of cannabis on public lands and the attendant public safety and environmental dangers posed by cannabis production on public lands; and

8) Preventing cannabis possession or use on federal property.

This list of priorities would seem to blunt any arguments that the federal government is looking to override the state laws that allow some use of cannabis. Yet the Cole memo also includes the following language left open to broad interpretations.

> *If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms.*

The FinCEN guidance and the Cole memo do not provide a safe harbor to financial institutions, but rather outline a series of actions that ultimately are not a guarantee that an institution could face sanction. Furthermore, financial institutions face the uncertainty that should federal enforcement of drug laws increase, even with state level marijuana legalization, that they run the risk of having assets seized or frozen, particularly assets that have been used as collateral for loans and lines of credit with financial institutions. Without a change to the status of cannabis as a Schedule I drug at the federal level, businesses legal under state law will continue to operate in a murky area where enforcement of federal law is only as consistent as federal policy, versus statute, wants it to be.

Fourth Corner Credit Union was established to serve the cannabis business in Colorado but was unable to get access to the Federal Reserve System and ultimately filed legal action against the Federal Reserve Bank of Kansas City, *Fourth Corner Credit Union v. Federal Reserve Bank of*

Kansas City (D. Colo., 15-cv-01633). In January of 2016 the case was dismissed. In the order dismissing the case, the presiding judge offered the following in relation to the Cole Memo and FinCEN guidance:

> *Plaintiff contends that the FinCEN guidance and Cole memorandum already provide federal authorization to financial institutions to serve MRBs. Therefore, offering to serve MRBs only if authorized by federal law is something of a sleight of hand. The problem is, the FinCEN guidance and Cole memorandum do nothing of the sort. On the contrary, the Cole memorandum emphatically reiterates that the manufacture and distribution of marijuana violates the Controlled Substances Act, and that the DOJ is committed to enforcement of that Act. It directs federal prosecutors to apply certain priorities in making enforcement decisions, but it does not change the law. The FinCEN guidance acknowledges that financial transactions involving MRBs generally involve funds derived from illegal activity, and that banks must report such transactions as "suspicious activity." It then, hypocritically in my view, simplifies the reporting requirements. In short, these guidance documents simply suggest that prosecutors and bank regulators might "look the other way" if financial institutions don't mind violating the law. A federal court cannot look the other way. I regard the situation as untenable and hope that it will soon be addressed and resolved by Congress.*

An initial analysis of the decision makes it clear that the creation of a state licensed bank or credit union created for the purpose of servicing MCBs is not a legally viable option until federal law is changed.

The difficulties of banking MSBs has become magnified as many other states have legalized marijuana either by expanding medical marijuana usage or the full scale legalization such as in Colorado. In response to this growth several companies have created banking alternatives designed to provide electronic transactions for MCBs and assist with FinCEN and *Cole Memo* requirements. These alternatives range from kiosk type interface systems that allow customer payment and order without exchanging cash at the MCB to mobile phone applications that service as a digital wallet to allow customers to pay with their phone from an account that is preloaded with funds. Many of these systems also include inventory management, product tracking and customer transaction tracking in an attempt to comply with the requirements under federal anti-money laundering laws. A recent article (February 16, 2016) in The New York Times, *As Marijuana Sales Grow, Start-Ups Step In for Wary Banks* stated:

> *Most of the start-ups trying to help with this problem are focuses in one way or another, on tracking every detail of every purchase in a more sophisticated way. Careful record-keeping can answer the concerns of banks worried about violating anti-money laundering laws.*

Careful record keeping can assuage concerns about anti-money laundering violations, but it would be overly simplistic to state that financial institutions are concerned only with this one aspect given the various concerns already outlined in this document.

Marijuana's inclusion under the CSA leaves states with legalized marijuana, whether for medical or recreational use, in a difficult position where any potential safe harbor is only as good so long as federal enforcement of the CSA ignores states with legalization. However, financial institutions face this problem even more directly due to their regulatory nexus with the federal government via the need for deposit insurance and access to the Federal Reserve. These are not

the only considerations, as previously banking regulators have urged banks to avoid reputational risk involved with banking certain "high risk" although legal, industries.

The current difficulties will only increases exponentially. The implementation of California's medical marijuana regulations and the prospect of full scale legalized recreational use will expand the volume of business and state licensing fees will need to be paid in addition to taxes and potential local fees. The payment of licensing fees and taxes will remain problematic until the banking question is answered. MMRSA requires an initial and yearly licensing fee which is likely to be paid in cash unless a solution is reached. Media reports suggested that cities and counties throughout the state are considering additional marijuana fees and taxes, yet these jurisdictions will have to deal with large amounts of cash to cover these payments. These are obstacles for the current legal medical marijuana industry.

However, the essential deciding factor that will open up access to banking would be either a change of the CSA to remove marijuana from the list of controlled substances or the creation of a safe harbor for financial institutions that offer accounts to state legalized MCBs.

Discussion:

The Assembly Banking & Finance Committee conducted an oversight hearing on February 29th, 2015, *Banking the Medical Cannabis Industry.* Based on witness testimony provided from a wide range of stakeholders financial institutions face many obstacles in banking MCBs. A limited number of financial institutions bank MCBs sometimes unknowingly. The hearing confirmed what the research already suggests, that state laws and regulations are not the obstacle, nor necessarily the solution for banking MCBs. Rather, federal law creates heightened risk and until federal law is changed that risk cannot be fully mitigated by changes to state law.

The banking related provisions of AB 1575 are problematic from both an implementation standpoint and their actual impact. The following are issues requiring attention.

1) The requirement for DBO to create an enhanced financial monitoring certification so licensees under the Act can comply with federal banking regulations creates a quasi-licensing scheme without providing DBO with appropriate enforcement authority. Additionally, it lacks detail on how the certification process would work and whether DBO could pass regulations.

   No other financial services licensing law provides a certification. Furthermore, this provision would place MCBs that are not financial service entities under partial authority of DBO. This would set a precedent of allowing a financial regulator to have oversight over what are effectively wholesale and retail operations of non-financial entities.

   A certification may also inadvertently give MCBs false security in that they could interpret the certification as protecting them from liability that could occur do to federal law. The potential costs of such a program could limit certification, assuming certification provides any value, to large MCBs that can afford an additional level of costs. Finally, it requires a state regulator to certify activity that could be subject to federal enforcement action.

2) AB 1575 would exempt a financial institution that provides financial services to a licensed MCB from any criminal law of the state. As noted previously, the difficulty in banking

MCBs is due to federal law. Staff is unaware of any state level banking enforcement actions against MCBs or a financial services provider.

The state of Oregon recently passed a very similar bill to remove criminal liability for financial institutions that serve MCBs. The Oregon legislation for which this section mirrors provides no real benefit from the underlying problem, and that is federal law. Staff believes that such an approach will only provide a false sense of hope to MCBs and that ultimately it will not do anything to change the current situation. A state law is also unable to provide any legal immunity from federal law. Finally, this section has a major drafting problem in that it would exempt a financial institution "from any criminal law" even if the law is unrelated to MCBs activities.

3) The requirement that BOE form an advisory group should include DBO as they are the chief regulator of financial institutions and other financial service providers in the state.

Amendments:

Based on the issues outlined previously, staff recommends the following amendments to Section 8 of the bill.

Section 19310.5. of the B&P Code:

(a) It is the intent of the Legislature to enact a statute that improves the medical cannabis industry's ability to comply with federal law and regulations that would allow improved access to banking services.

(b) (1) The State Board of Equalization ***in conjunction with the Department of Business Oversight*** shall form an advisory group made up of representatives from financial institutions, ***non-bank financial service providers,*** the medical cannabis industry, law enforcement, and ~~state and~~ federal banking regulators. By July 1, 2017, the board ***in conjunction with department*** shall submit a report to the Legislature with ~~proposed changes to state law or regulations~~ ***recommendations from the advisory group*** that will improve financial monitoring of medical cannabis businesses. ~~and improve compliance with federal law~~.

(2) A report submitted pursuant to paragraph (1) shall be submitted in compliance with Section 9795 of the Government Code. The requirement for submitting a report imposed in paragraph (1) is inoperative on July 1, 2021, pursuant to Section 10231.5 of the Government Code.

~~(c) The advisory group shall examine strategies, such as the use of integrated point-of-sale systems with state track and trace systems and other measures that will improve financial monitoring of medical cannabis businesses.~~

~~(d) (1) The Department of Business Oversight shall create an enhanced financial monitoring certification for entities licensed pursuant to this chapter that further enables those entities to comply with the federal banking regulations under the federal Bank Secrecy Act. The Department of Business Oversight shall consider including requirements to use electronic financial monitoring that enables real-time sales inventory tracking and other tools that allow a bank or credit union to readily access information they are required to monitor under the federal Bank Secrecy Act.~~

~~(2) The Department of Business Oversight may collect fees from applicants requesting the enhanced financial monitoring certification in an amount sufficient to fund the actual reasonable costs of implementing subdivision (d).~~

~~(3) After the Bureau of Medical Cannabis Regulation posts a notice on its Internet Web site that the licensing authorities have commenced issuing licenses pursuant to the Medical Cannabis Regulation and Safety Act, a financial institution that provides financial services customarily provided by financial institutions to other entities to a current licensee under the Medical Cannabis Regulation and Safety Act is exempt from any criminal law of this state, provided that the financial institution has verified the licensee has a valid license in good standing.~~

~~(4) The Bureau of Medical Cannabis Regulation may provide information to a financial institution to verify the status of a licensee.~~

REGISTERED SUPPORT / OPPOSITION:

Support

Consortium Management Group

Opposition

1 individual

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