

Date of Hearing: August 24, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AJR 25 (Lackey) – As Introduced June 25, 2015

**SUBJECT:** Access to financial institutions

**SUMMARY:** Memorializes the President and Congress of the United States to support legislation that will provide a comprehensive solution to allow banks and credit unions to perform financial services for cannabis businesses. Specifically, **this bill:**

1) Makes the following findings:

- a) Cannabis use for medical purposes is legal in 23 states and is legal for recreational purposes in four states and in the District of Columbia. The expansion of cannabis businesses across the United States requires action from Congress and the federal government;
- b) Many states have laws permitting various degrees of commercial activity using cannabis, it still remains illegal under federal law;
- c) The conflict between federal and state laws has left financial institutions serving cannabis-related businesses on uncertain legal ground. Banks and credit unions are concerned that providing financial services for businesses selling a product that is illegal under federal law exposes them to possible charges of money laundering and drug trafficking;
- d) Federal laws, including the Controlled Substances Act, the Bank Secrecy Act (BSA), and the Annunzio-Wylie Anti-Money Laundering Act, prohibit financial institutions from providing financial services to cannabis and hemp businesses;
- e) Directives from federal regulatory agencies such as the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency also prohibit bankers from accepting deposits from cannabis or hemp businesses;
- f) In February 2014, the United States Treasury's Financial Crimes Enforcement Network (FinCEN), in coordination with the United States Department of Justice, also issued a memo outlining expectations for compliance with the BSA;
- g) The medical, retail, and hemp agricultural businesses are unable to accept credit or debit cards from customers because electronic payments are handled through the banking system. Therefore, transactions must be conducted in cash;
- h) The lack of financial services makes paying taxes to local governments and the California State Board of Equalization (BOE) a challenge because tax payments must be made in cash by cannabis-related businesses, leading to hundreds of thousands of dollars in cash being brought directly into government offices. It is difficult for the BOE to audit cash-based businesses, especially when records of wholesale transactions are not available;

- i) Cannabis businesses cannot easily comply with California tax laws, which has led to a significant underpayment of revenue owed the state; and,
  - j) The BOE launched the Cannabis Compliance Pilot Project in January 2015 to help determine both the degree of noncompliance with state tax law and the amount of lost tax revenue.
- 2) Urges the President and Congress to support legislation which will provide a comprehensive solution to allow banks and credit unions to perform financial services for cannabis businesses without federal retribution. The current system that requires cash-based transactions poses a risk to public safety and leads to reduced collection of taxes.
- 3) Requests that the Chief Clerk of the Assembly transmit copies of this resolution to the President and the Vice President of the United States, to the Speaker of the House of Representatives, to the Minority Leader of the House of Representatives, to the Majority Leader of the Senate, to the Minority Leader of the Senate, and to each Senator and Representative from California in the Congress of the United States.

**EXISTING LAW:** In 1996, voters approved Proposition 215, known as the Compassionate use Act of 1996 (CUA). The CUA allowed patients and primary caregivers to obtain and use medical cannabis, as recommended by a physician, and prohibited physicians from being punished or denied any right or privilege for making a medical cannabis recommendation to a patient. In 2003, SB 420 (Vasconcellos, 2003) allowed patients and primary caregivers to collectively and cooperatively cultivate medical cannabis, and established a medical cannabis card program for patients to use on a voluntary basis. Despite the CUA and SB 420, cannabis is still illegal under federal law.

**FISCAL EFFECT:** None

**COMMENTS:**

A longstanding issue faced by those operating in the medical cannabis business in California is the lack of banking services. Stories abound of businesses ranging from dispensaries to growers all operating within California's legal framework facing the closure of bank accounts and being denied access to bank 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 had hoped that the guidance would provide greater clarity and potentially open up more financial institutions for access. Unfortunately those hopes were up in smoke as the guidance only added further confusion and did little to eliminate the risk faced by financial institutions.

Banks are required to file suspicious activity reports (SARs) when they think that a transaction might have a drug connection. Rather than clarify the existing SAR process for legal cannabis business 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. A year and half 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.

A solution was almost found in Colorado as Denver-based Fourth Corner Credit Union was established to serve the financial needs of the cannabis and hemp industries. Fourth Corner ran into problems when it reached out to the Federal Bank of Kansas City to get a master account. A master account is effectively a bank's bank account. Master accounts at Fed branches allow banks to not only deposit their cash reserves, but gives banks the ability to easily transact business with other financial institutions by settling credits and debits through the account at that Fed branch bank. A financial institution without a master account would be prevented from conducting most types of electronic funds transfers. Fourth Corner has filed legal action against the Federal Reserve Bank of Kansas City.

#### California impact.

In October 2005 the BOE directed staff to issue seller's permits to all retailers of medical cannabis in order for those retailers to collect and remit sales tax. In spite of this policy it is still difficult to determine the total amount of cannabis business in California because taxpayers can "decline to state" the type of property they sell in order to avoid self-incrimination.

In February 2014, BOE established a policy to no longer accept cash payments and instead encourage taxpayers to pay online using their bank account information. A "No Cash Exemption Request" was created to assist medical cannabis retailers as they have mostly cash-based businesses and have fears of having assets seized if they were able to open a bank account. These cash based businesses have put additional cost pressures on BOE as it makes it difficult to conduct record verification and track gross retail sales of medical cannabis.

Earlier this year, BOE established the Cannabis Compliance Pilot Project (project) to assess the degree of tax compliance in the industry and identify the corresponding lost tax revenue. The project has the following goals:

- 1) Determine the scope of non-compliance and identify the current and potential tax revenue, volume of cannabis produced, California's rate of consumption, lost revenue due to non-compliance, and current industry practices;
- 2) Identify barriers that impede voluntary tax compliance by each segment of the industry (e.g., growers, distributors, retailers) for the purpose of developing strategies to address the barriers;
- 3) In coordination with Legislative Division and relevant program staff, provide recommendations (statutory, regulatory, policy) for increasing voluntary compliance among growers and retailers; and,
- 4) Coordinate with Legislative Division and relevant program staff on issues related to cannabis.

#### Project Objectives:

- 1) Provide estimates for the following: current sales and use tax revenue, potential sales and use tax revenue, volume of cannabis produced, volume necessary to satisfy California's current rate of consumption, and lost revenue due to non-compliance.

- 2) Provide an agency strategy and recommendations to overcome barriers and increase voluntary compliance.
- 3) Identify key industry stakeholders and their legal and government affairs representatives to gain a better understanding of industry specific business practices, while helping establish and leverage credibility among local retailers and growers to proactively address current and future obstacles to industry compliance.
- 4) Collaborate with other state and federal agencies (ABC, EDD, FTB, IRS, DOJ, SWQCB, etc.) to identify current and potential regulatory and administrative issues related to the taxation of cannabis.

#### Congressional action.

Congressman Perlmutter (D-Colorado) has introduced H.R. 2076 - Marijuana Businesses Access to Banking Act of 2015. H.R. 2076 would provide a safe harbor for depository institutions that provide products or services to legal cannabis businesses and prohibits a federal banking regulator from: (1) terminating or limiting the deposit or share insurance of a depository institution solely because it provides financial services to a cannabis-related legitimate business; or (2) prohibiting, penalizing, or otherwise discouraging a depository institution from offering such services.

#### Additional considerations.

The complex issues associated with banking legal medical cannabis businesses cannot easily be rolled up. Medicinal cannabis is legal in 23 states and legal for recreational purposes in four states and the District of Columbia yet still illegal under federal law. At any given moment those entities operating legally under state law could face legal action from federal prosecutors and have their assets seized. The current federal enforcement policy is contained in a document known as the *Cole memo*. The *Cole memo* was issued on August 29th, 2013 by James M. Cole, United States Department of Justice Deputy Attorney General. 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.*

Even in the event that financial institutions are given a safe harbor to bank cannabis businesses such safe harbors may not go far enough to protect assets from seizure, 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. A change in Presidential administration could drastically alter the views and actions of federal law enforcement entities. Providing greater clarity for financial institutions may provide a temporary short-term solution to the banking question. However, only when federal law is changed to remove cannabis from Schedule I of the Controlled Substances Act or the federal courts clearly recognizes the right of states to establish their own policy in this regard will the cannabis industry have true legal protection when using financial institutions.

Until then, both financial institutions and cannabis businesses will still operate in a cloudy legal space.

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

State Board of Equalization, Fiona Ma, (Co-Sponsor)  
State Board of Equalization, George Runner, Vice Chair (Co-Sponsor)  
California Cannabis Industry Association  
California Credit Union League

### **Opposition**

None on file.

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