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Five Ideas That Can Solve the Cannabis Banking Problem

Despite this exponential growth, the cannabis industry still suffers from the lack of even the most basic financial serv It's a problem that over-anxious legislatures have simply avoided and swept under the rug, so as to not disturb the potential tax revenue that awaited them on the upside.

By **Joann Needleman** | May 22, 2019 at 12:58 PM

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[\(htt](#)**Joann Needleman of Clark Hill.**

The cannabis "goldrush" shows no sign of letting up. As of January, there are more states that have legalized marijuana in some form, whether for medical or recreational use, than the 17 states that have no legalization whatsoever. For those 33 states and the District of Columbia, business is booming. A recent study from New Frontier Data, a data analytics firm focused on the cannabis industry, found that revenue from legalized marijuana nationwide would create at least \$132 billion in tax revenue and more than a million new jobs across the United States in the next decade. This is good news for those investing in this burgeoning industry, until it comes time to reap the rewards. Despite this exponential growth, the cannabis industry still suffers from the lack of even the most basic financial services. It's a

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problem that over-anxious legislatures have simply avoided and swept under the rug, so as to not disturb the potential tax revenue that awaited them on the upside. With a 50-state legalization on the horizon, the time to bury our heads in the sand is over.

But what to do? To be fair, Congress has been focusing on this issue this past year. Several bills are starting to gain some traction and are moving through committees but they are piecemeal attempts to solve a problem that needs an overall holistic approach. The following are five ideas that if implemented could allow the cannabis industry to better integrate into and align with our nation's banking system.

Marijuana Must be Reclassified Under the CSA

Marijuana remains classified as a Schedule I substance under the Controlled Substances Act (CSA). Section 811 of the CSA authorizes the U.S. Attorney General to set the criteria for classification of substances, including the removal of any drug or substance from the schedules if it is found that the drug or other substance does not meet the requirements for inclusion in any schedule. Schedule I drugs are substances or chemicals "with no currently accepted medical use and a high potential for abuse." Not only is marijuana now used medicinally with proven results, but there are studies that conclude that medical cannabis use is associated with an overall decrease in opioid use. A 2016 Israeli study found that 44% of 176 opioid-using patients were able to discontinue opioid therapy entirely seven months after they began smoking cannabis or eating cannabis-infused cookies. Current Attorney General, William Barr, stated in his confirmation hearing that the discrepancy between federal and state law is unattainable and that he would look favorably to a federal approach so that states can comply. If that is true, then a reclassification and removal of marijuana from Schedule I is the only effective alternative.

Various bills floated in Congress seeking to amend the CSA, implement a reverse preemption rather than reclassifying the legal status of marijuana. The STATES Act, proposed by Sens. Elizabeth Warren (D. Mass.) and Cory Gardner (R. Colo.) looks to exempt marijuana from enforcement under the CSA if a state has legalized it. The SAFE Banking Act, proposed by U.S. Rep. Edward Perlmutter (D. Colo.), has garnered broad bi-partisan support and would, among other things, prohibit the Federal Deposit Insurance Corp. (FDIC) from denying a financial institution deposit insurance or penalizing the financial institution for providing financial services to cannabis businesses. Neither of these bills attack the root of the problem: as long as marijuana is a Schedule I drug, banking regulators are hamstrung in fulfilling their statutory duty to ensure that financial institutions are not laundering money from illegal activity. As long as marijuana is a Schedule I drug and proceeds of the sale of marijuana are deposited into a federally insured banking institution, federal law will be violated.

FinCEN Needs to Update the Cole Memo

With Attorney General Jeff Sessions' departure from the Department of Justice (DOJ), it is time for the Financial Crimes Enforcement Network (FinCEN), a division of the Department of the Treasury, to revise its guidance regarding the Bank Secrecy Act (BSA) for those financial institutions seeking to provide services to marijuana-related businesses. The Cole Memo spoke only to whether DOJ would turn a blind eye to enforcement. Now is the time for FinCEN to lay out a framework that financial

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institutions can follow in order to service its customers as well as its communities. Why can't FinCEN lay out specific guidelines that if followed, would protect a financial services entity from significant liability?

What About Revising Examination Procedures?

In addition to FinCEN, it seems somewhat unbelievable that in light of the growing cannabis commerce, the FDIC, the Federal Reserve, and in some instances the Office of the Comptroller of the Currency (OCC), have not updated their examination manuals to account for financial institutions that want to service the cannabis businesses and marijuana-related entities. Not too long ago I was meeting with a president of a regional bank and the conversation turned to cannabis banking. I asked whether the bank was considering servicing these businesses in the near future. The president smiled and lamented that the bank would love to have those deposits, but feared what future examinations with regulators would look like and more importantly, how much more it would cost. A standardized examination protocol would go a long way in ensuring that financial institutions are meeting the expectations of regulators and that regulators are getting assurances that those same institutions are adequately managing risk.

North Dakota May Hold the Answer

There is growing discussion about the establishment of state-owned banks modeled after the Bank of North Dakota (BND). California attempts at a public bank failed at the end of 2018. New Jersey and Michigan have similar bills pending but are facing numerous obstacles. While BND appears to be the best model, aspects of the BND should be carefully considered.

BND is a partnership with many of the state's financial institutions to promote the development of agriculture and commerce within the state. Today the bank is run by an advisory board established by statute. The state authorizes the amount of employees and while it is not a member of the FDIC, it has a business relationship with the Minneapolis Federal Reserve. The bank provides certain financial services that one would find at a traditional bank, including deposits and check processing. BND only provides student loans, and all other consumer or commercial lending must be in conjunction with another financial institution with which BND would partner. Profits of the bank go back to the state.

The BND model offers an infrastructure for the safe banking of cannabis. In a state like Colorado, the revenues already generated from cannabis are certainly enough to get a jump start on at least a prototype public bank in that state. The population discrepancy between North Dakota and states like California and New Jersey should not discourage this discussion. A state-owned bank would have no shortage of deposits. These deposits would lead to unlimited lending opportunities within the cannabis industry, and those profits would go back to the state's own coffers. Many municipalities, like Los Angeles and the city of Seattle, are analyzing whether this model can work in a condensed geographical area. Other large cities or regional areas within a state should consider this option as well.

Technology and Information Sharing Solutions

The primary road block for banks has been the ability to comply with current bank anti-money laundering regulations, specifically "know your customer" (KYC) and submitting mandatory suspicious activity reports (SARs). Failure to adequately comply with these requirements can result in significant fines and penalties. This

issue comes down to information and information sharing. In California, an Assembly bill would authorize state regulators to share cultivation and shipping information collected from cannabis businesses using banks, through sales data. Supporters expect this will offer assurances to financial institutions that a marijuana shop or grower is operating within the law. A Colorado firm, NCS Analytics, is building a data portal between banks, states and marijuana-related businesses that sifts through information to alert bankers and regulators to suspicious activity. The portal shares state's tracking, licensing and tax data as well as marijuana-related firms' internal accounting software data, buyers' demographic data and more. Expect other technology companies to enter the market to enhance KYC capabilities.

Cannabis will be a hot topic in the 2020 elections. Republican challenger, Bill Weld, sits on the Board of Acreage, a cannabis company, and spoke at the 2018 Cannabis World Congress. All Democratic candidates, except Joe Biden, believe that marijuana should be decriminalized and removed from the Schedule I designation. Given that the front runners from both parties may not be looking to change the status quo, expect the solutions to be slow in coming.

Joann Needleman is a member of Clark Hill and the leader of the firm's consumer financial services regulatory & compliance practice group, based in the Philadelphia office. She serves as a navigator to her clients seeking advice and guidance in the complex regulatory environment facing the financial services industry, and is a former member of the consumer financial protection bureau's (CFPB) consumer advisory board. Needleman is also a member of the firm's cannabis industry financial services task force working with owners, investors, lenders and financial-services providers in the cannabis industry to inform them of the enforcement priorities of federal agencies.

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