Aite PARTNER. ADVISOR. CATALYST.

Cash in the U.S. Legal Cannabis Market: The Unseen Cost of Cash in a Pandemic

MAY 2020

Prepared for:

EMERGING MARKETS COALITION

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

EMERGING MARKETS COALITION—PREFACE

There is a flood of information and a desert of facts in the cannabis financial services industry.

As someone long in financial services and payments, I can confirm that the legal cannabis industries (and ancillary businesses) represent some of the largest greenfield opportunities to the financial services and payments industries in decades.

However, the cannabis industry still mostly transacts in cash. There are some alternative payment options, but nothing ubiquitous to enable this legal industry to grow and better serve its consumers—especially those who are medically using cannabis in place of opiates and other highly addictive or expensive drugs.

Cash presents a number of critical challenges, including making it easier for criminals to transact in an opaque/untraceable way. This forced reliance on cash, due to federal scheduling of cannabis, is a public safety issue for schools, communities, and the entire United States—both because of physical security and, in this current age of epidemics, because cash is an alarmingly effective transmission tool for pathogens.

Traditional financial services industry players have been hesitant to enter this market, largely driven by the conflict between state and federal laws, and the fact that cannabis is still federally a Schedule I drug. This means that the more than 30,000 legal operators, from dispensaries through to farmers, in this space lack full (in some cases any) access to basic financial services—banking, lending, payments, investments, insurance, and more—because of a lack of clarity in legislation, regulation, and compliance requirements. Additionally, many investors are deterred by an opaque emerging market with regulatory uncertainty.

This study was commissioned by the members of the Emerging Market Coalition (EMC), a not-for-profit organization driving to normalize financial services in this dramatically growing legal industry. EMC is a coalition of the thought leaders and market-makers in the financial and cannabis industries. As a collaborative effort and voice spanning both industries, EMC seeks to set the standard in financial transparency, traceability, and fair taxation. EMC's Pillars of Action are educate, advocate, protect, and promote.

A special thank you to Kevin Morrison (NeCo technologies) and Kelly Whyman (CannDo LLC) for sharing their deep expertise, resources, and powerful network in the cannabis and financial services industries and for contributing to this paper.

EMC invites you to join the collective voice and to drive financial transactions to be fully transparent, traceable, and taxable.

Kirsten Trusko

CEO and Co-Founder, Emerging Markets Coalition

INTRODUCTION

Ever since California became the first state to legalize medical cannabis in 1996, the U.S. legal cannabis market has continued to expand and evolve in new and often surprising ways. While growth has been high, the legal cannabis sector has faced significant challenges in gaining access to financial services. While the banking situation for legal cannabis is continually evolving, it has resulted in an overreliance on cash that causes significant problems for the industry and holds knock-on effects for cannabis businesses, banks, tax collection, law enforcement, regulators, and public health and safety. Despite challenges, the cannabis sector holds significant opportunities for banks as the market continues to expand.

This white paper, produced by Aite Group in conjunction with EMC, is intended to serve as a snapshot of the use of cash in the legal cannabis sector. It looks at the legal underpinnings that force such a heavy reliance on cash, the current and forecast use of cash in the medical and adult-use space, and some of the opportunities for banks and other financial institutions. While banking cannabis remains challenging, the level of opportunity is still growing and changing from a legal perspective. It will remain a dynamic space for the foreseeable future.

METHODOLOGY

This report is primarily based on publicly available data sources, including official statistics from state-level bodies and tax authorities, the Financial Crime Enforcement Network (FinCEN), and the Federal Deposit Insurance Corporation (FDIC), and on Aite Group's own in-house data modeling, among other sources. This is backed up by qualitative briefings and ongoing conversations with members and partners of EMC, which enabled an intersection of experts in the cannabis market and financial services.

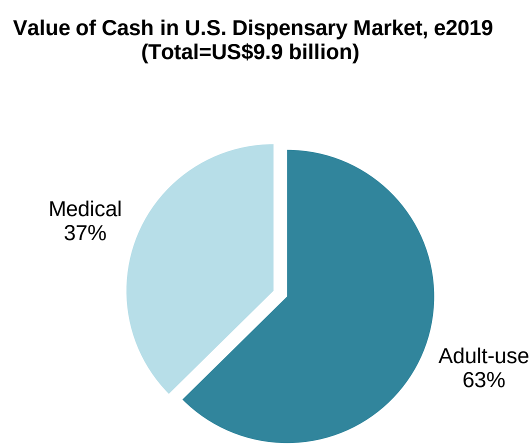
U.S. CONSUMERS ARE SPENDING MORE THAN EVER ON LEGAL CANNABIS

The legal cannabis market in the U.S. is growing and continues to expand on a state-by-state basis. As of Q1 2020, 11 states have legalized both adult-use and medical cannabis, a further 22 have medical legislation in place, and 13 have some limited forms of CBD available; only four states have not passed any legislation at all regarding legalizing or decriminalizing any aspect of cannabis. The market was also given a further boost in 2018 with the full legalization of non-THC hemp under the 2018 U.S. Farm Bill.

As the legal position of cannabis evolves on a state-by-state basis, the size of the overall market continues to rise year on year. Aite Group conservatively estimates that U.S. consumers spent US$9.9 billion in cash on legal cannabis across nearly 4,000 adult-use and medical dispensaries in 2019. Of that figure, nearly US$6.2 billion was spent on adult-use cannabis and US$3.7 billion on medical cannabis, a rough split of two-thirds to one-third of the market (Figure 1). These estimates are based on available tax revenue, dispensary numbers, and consumption statistics on a state-by-state basis from official government sources. Aite Group notes these figures do not include the sizeable black market for cannabis, which even in full legal states may be equal to or greater than the value of the legal market.

Aite Group notes these figures also do not include the substantial ancillary industry surrounding legal cannabis or the newly legal hemp market, including for cultivation, processing, and other support services, nor do they take into account the substantial and growing market for CBD-based products ranging from beauty creams and supplements to pet treats. The overall economic effect of cannabis will be significantly larger than the US$9.9 billion listed here and will extend into other markets over time.

Figure 1: U.S. Consumers Spent US$9.9 Billion in Cash at Legal Dispensaries in 2019



Source: Aite Group

CANNABIS SPENDING WILL WEATHER THE ECONOMIC STORM

While the US$9.9 billion in cash transactions alone already represents a sizeable U.S. market composed predominantly of small businesses, the market is set to see significant growth over the next several years. Cash spending at dispensaries is likely to continue to grow at a sharp rate, with the market nearly doubling to US$19 billion by 2022. The market will see an overall compound annual growth rate (CAGR) of 26% between 2018 and 2022 (Figure 2). This growth will be underpinned by rising maturity levels in newly legal markets and a growing number of states moving toward liberalization in line with rapidly shifting public attitudes.

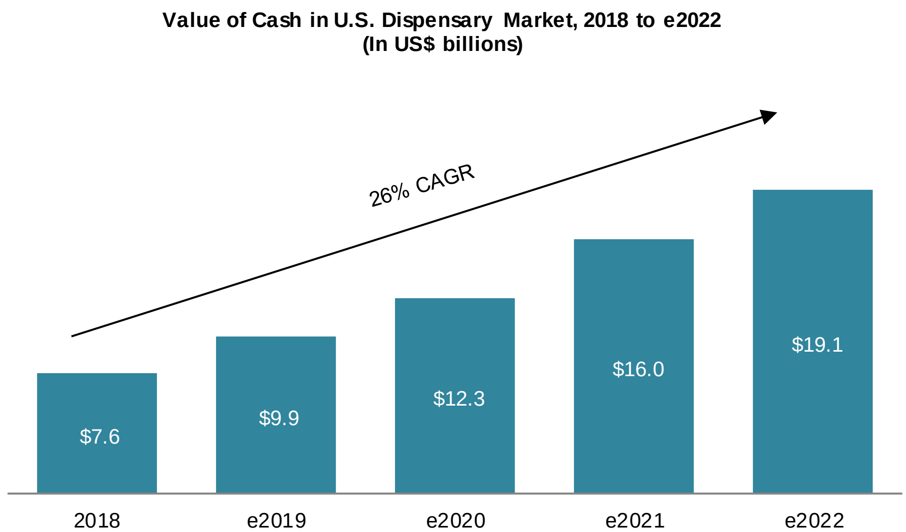
Despite the economic shockwaves now being felt internationally as a result of COVID-19, spending by U.S. consumers on cannabis will continue to grow in the year ahead, albeit at a reduced rate than previous years. Aite Group forecasts a 25% increase in spending on cannabis between 2019 and 2020. As the legal cannabis market is still relatively new, it's too early to say whether it is truly recession-proof like sectors such as healthcare. The sector undoubtedly faces major challenges, much like other industries, including difficulties sourcing supplies (such as packaging and equipment), ensuring staff and customer safety, and dealing with closures where relevant. However, evidence from past downturns suggests that consumers will often spend more on smaller luxuries and forms of escape, such as makeup and alcohol, during periods of economic crisis.[1] This pattern is likely to be repeated.

Further, legal cannabis, particularly medical cannabis, has been deemed an essential business in many markets amid the pandemic lockdowns. Early reports suggest significant levels of stockpiling have occurred, contributing to a burst in spending. In many instances, dispensaries are allowed to operate with shelter-in-place protocols via curbside pickup and delivery only. With stress levels high among many consumers, the urge to self-medicate will also likely remain strong. Meanwhile, the impact of shelter-in-place procedures is driving up black-market prices for cannabis and other drugs, which pre-pandemic could be up to half the price of legal alternatives. This will likely prompt many to turn to legal cannabis as a more cost-effective alternative. Further, the continued aging of the now-retiring baby boomer generation and growing interest in alternative medicines from all generations will continue to push overall demand for cannabis products both in 2020 and beyond.

Aite Group notes that while spending in the cannabis space will rise, the broader cannabis market, including in the cultivation and processing corners of the market, will likely continue to see turmoil, much as it has in recent years. Similar to the early troubles of the dot-com boom, many businesses (often with shaky business plans and revenue models) have rapidly entered the market, and not all of them will survive. Despite these high-profile business challenges, the fact remains that consumers are spending more than ever on legal cannabis and will continue to do so in the near term.

1. Aaron Smith, "Alcohol Sales Thrive in Hard Times," CNN Money, June 9, 2011, accessed April 8, 2020, https://money.cnn.com/2011/06/08/news/companies/alcohol_sales/index.htm.

Figure 2: Cash Spending Will Reach US$19 Billion by 2022



Source: Aite Group

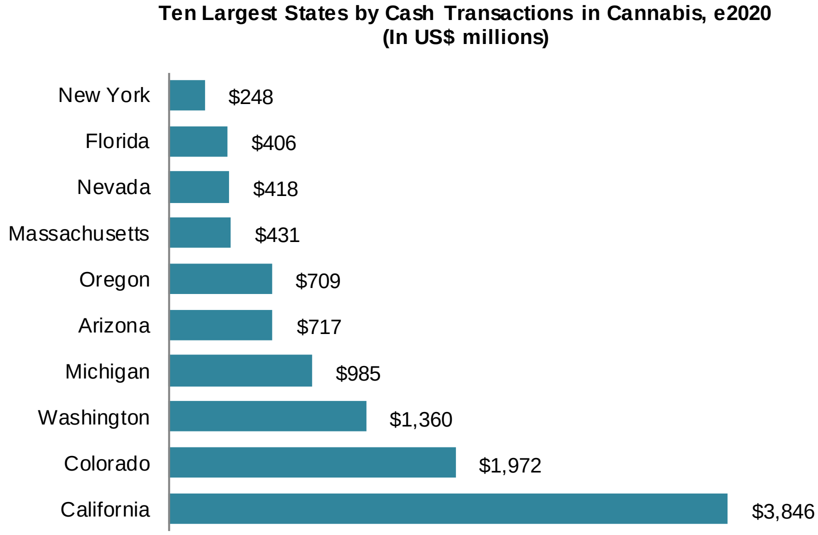
CALIFORNIA MAY BE THE BIGGEST STATE, BUT OPPORTUNITY FOR GROWTH EXISTS EVERYWHERE

With the legal situation varying at a state level, it's no surprise that the size of cannabis spending varies immensely by state. Unsurprisingly, California and Colorado are the largest and most established states for legal cannabis, accounting for nearly 45% of the market. Aite Group forecasts that California and Colorado will see cash spending of nearly US$3.8 billion and just over US$1.9 billion, respectively, in 2020.

Although the market is not evenly spread, opportunity for growth is strong everywhere. Many of the other largest states represent major opportunities for continued development and growth. Michigan, for instance, with its forecast spending of over US$985 million in 2020, is still a newly legalized state with further opportunity for growth. Arizona, by contrast a medical-only state, will continue to see major growth, with spending of US$717 million forecast for 2020, fueled in large part by its significant retiree population. Other notable areas of rapid growth are Florida and Oklahoma, among others (Figure 3).

As the dispensary market grows and evolves, many of the operators involved in the space are becoming increasingly sophisticated retail and medical environments. This includes services ranging from personal concierges and delivery to the development of lifestyle brands and a more gentrified, luxury consumer experience. Not the small-scale bohemian shops of the popular imagination, dispensaries are increasingly taking their cues from Apple and Starbucks in their retail development. This means that dispensaries are becoming more sophisticated and brand conscious, and this will further increase the opportunity for revenue growth.

Figure 3: California Is the Biggest State for Cannabis Spending, but Opportunity Is Everywhere



Source: Aite Group

CASH IN CANNABIS IS PROBLEMATIC

Chief among the legal cannabis sector's banking problems is a reliance on cash due to a lack of payment alternatives. Due to the Schedule I status of cannabis, making it federally illegal regardless of state-level legislation, the major consumer payment networks of Visa, Mastercard, American Express, and Discover will not offer payment processing services to dispensaries and other cannabis-related businesses in the U.S., resulting in a reliance on cash or other alternatives. The dependence on cash is proving hugely problematic from an anti-crime, tax collection, industry regulation, and now public health perspective. As the wider economy and public consciousness enter a new and unprecedented period of change brought on by the new coronavirus, the long-standing reliance on cash in the legal cannabis sector is becoming increasingly untenable.

Alternatives to both cash and the traditional payment networks have emerged in recent years, typically in the form of fintech companies focused on alternative mechanisms, including mobile wallets, reverse cash machines, and prepaid functions; however, these remain niche propositions in most instances that are often shut down if they are caught flouting card network rules. As a result, Aite Group estimates that at least 90% of all dispensary transactions are handled in cash, equivalent to US$9.9 billion in cash in 2019 alone.

The overreliance on cash poses numerous problems, including the following:

- Physical cash may carry risks of contagion.
- Significant security issues arise, including becoming a target for armed robberies.
- Cash businesses provide an easy front for money laundering, including for the drug cartels.
- Maintaining an accurate audit trail for accounting, compliance, and tax collection purposes is a challenge.
- Legacy cash stockpiles remain problematic in newly legal states and are a challenge for dispensaries, banks, and regulators alike.
- Physically handling and collecting such large quantities of cash is itself a challenge.
- Day-to-day operations, such as payroll or paying suppliers and other business expenses, can be difficult.

CASH IS NOW A PUBLIC SAFETY ISSUE

In early 2020, the world is facing an unprecedented public health challenge brought on by the COVID-19 pandemic, and the repercussions of this are now playing out across almost all economic sectors. As of the time of this writing in Q2 2020, growing numbers of organizations are moving away from cash and toward electronic payment mechanisms as a means to enhance public health and safety and to build on long-standing trends of consumers' and businesses' preference for electronic payment mechanisms. While the World Health Organization reports that there is no evidence of COVID-19 transmission due to cash usage,[2] retailers and regulators have made moves to reduce cash usage in many sectors and even physically disinfect cash stores. Many of these concerns are based on a slew of studies that show the contaminant potential for cash. A 2008 Swiss study, for instance, found that flu viruses can survive for 17 days on physical cash.[3]

Dispensaries in some state markets are now facing contradictory claims whereby regulators are pushing for social distancing measures but nonetheless restricting dispensaries to cash payments. Colorado, for instance, has gone so far as to issue emergency regulations enabling marijuana businesses to fill phone and internet orders as well as practice social distancing, but it also mandates that payments must be done on the premises. Colorado also no longer accepts cash when applicants for marijuana licensing pay their regulatory fees to the Marijuana Enforcement Division.[4]

Even the few cash alternatives, including reverse ATMs and traditional ATMs, are high-risk physical surfaces that can be shared by many people and become disease vectors. This risk of contagion in cannabis cash is particularly problematic for the medical cannabis sector, as many consumers will have underlying health issues and will be at added risk. After the COVID-19 crisis, the reliance on cash is likely to become a concern for many health regulators, but until then, cash in the cannabis market poses a potential health risk.

CASH IS ALSO A CRIME ISSUE

Unsurprisingly, given the significant amounts of cash circulating in the dispensary market, the reliance on cash has proven in many instances to draw criminal enterprises and be a potential target for organized crime, including for both extortion and money laundering.[5] Rather than driving criminal activity in the wider community, dispensaries are often the victims of crime, and this poses challenges to dispensary employees and law enforcement.

Even where outright crime is low, the heavy use of cash necessitates the use of significant security protocols and resources from both dispensaries and public law enforcement. This takes up valuable police resources while also acting as a broader impediment to efficiency in the legal cannabis sector.

2. "WHO Says Currency Doesn't Transmit COVID-19 but Retailers Taking Precautions," Global News, March 21, 2020, accessed April 8, 2020, https://globalnews.ca/news/6712120/coronavirus-cash-precautions/.

3. Coco Ballantyne, "Dirty Money: Can the Flu Be Passed on Dollar Bills?" Scientific American, January 5, 2009, accessed April 8, 2020, https://blogs.scientificamerican.com/news-blog/dirty-money-can-the-flu-be-passed-o-2009-01-05/.

4. "Emergency Medical and Retail Marijuana Rules Adopted," Colorado Official State Web Portal, accessed April 8, 2020, https://www.colorado.gov/pacific/marijuana/news/emergency-medical-and-retail-marijuana-rules-adopted.

5. Kate Ly Johnston, "Pot May Be Legal, but Crime at Dispensaries Is Rising," Cross Town, December 10 2019, accessed April 13 2020, https://xtown.la/2019/12/10/pot-may-be-legal-but-crime-at-dispensaries-is-rising/.

CASH IS A TAX AND COMPLIANCE CHALLENGE

The reliance on cash poses other significant headaches for dispensaries, state tax authorities, regulators, and financial services providers. In many instances, the dependence on cash counteracts some of the benefits of cannabis liberalization that even opponents support, including reduced organized crime and significant tax revenue. The reliance on cash means accurate record-keeping and transparency (for tax collection and regulatory purposes) are inefficient and highly prone to abuse. As a result, even states that are collecting a growing volume of increasingly critical tax revenue from cannabis may be losing taxable revenue. With the tax bases in many states likely to be hit by economic challenges in the wake of COVID-19, the need for reliable tax collection is more important than ever.

LEGACY CASH IS AN ONGOING CHALLENGE IN MANY MARKETS

Dispensaries' historic lack of banking access means that many cannabis businesses have faced serious challenges with "legacy cash"—significant cash stockpiles (ranging from the hundreds of thousands up to the millions of dollars for any particular business) that these businesses are unable to safely bank. These issues tend to improve as cannabis businesses mature and form banking relationships at the state level. Nonetheless, every time a new state allows for the legal sale of cannabis products, cannabis businesses grow faster than their banking options and struggle to secure much-needed banking relationships.

Even where banking relationships are later formed, anti-money laundering and compliance restrictions make it difficult for banks to accept large stockpiles of cash. This heightens the risk of criminal activity surrounding legitimate businesses, including through extortion and racketeering from organized crime.

Sizing the volume of legacy cash still in circulation remains problematic, since by its nature legacy cash is hidden and difficult to track. However, California offers an indication of the challenge posed by legacy cash. While the market saw close to US$3.1 billion in legal sales in 2019, the black market saw sales of nearly US$8.7 billion and up to 3,000 unlicensed and illegally operating dispensaries.[6] That suggests that regulators and tax authorities could be missing out on up to three times the revenue they are currently generating from the legal market and hints at the amount of cash circulating in the full cannabis market in any single year.

Aite Group notes that the experience in Canada suggests the reliance on cash could change swiftly with the requisite legislation in place. Although the major payment networks were not vocal about their change in policy, once cannabis became legal for adult use across all Canadian provinces in 2018, all of them began processing payments on legal cannabis sales, including for U.S. cardholders in Canada. This immediately solved the cash problems that dispensaries in the region faced and greatly enhanced regulators' and legal cannabis businesses' ability to reduce criminal activity, improve audit trails, and ensure fully traceable tax collection.

6. James Queally and Patrick McGreevy, "Nearly 3,000 Illegal Marijuana Businesses Found in California Audit, Dwarfing Legal Trade," September 11, 2019, accessed April 8, 2020, https://www.latimes.com/california/story/2019-09-11/california-marijuana-black-market-dwarfs-legal-pot-industry.

CANNABIS IS AN OPPORTUNITY FOR BANKS

While a daunting proposition to many banks, the legal cannabis market is a significant opportunity as well, particularly during a period of economic uncertainty. The legal environment remains complex but is nonetheless in a phase of continued development and has major potential to change significantly in the near term. Further, the routes to entering the market for banks of all sizes are becoming easier as new entrants help to facilitate compliance and even source potential clients. Not all banks will have the appetite for cannabis at this stage, and this undoubtedly presents a significant opportunity for banks willing to take the plunge.

THE LEGAL ENVIRONMENT MAKES CASH KING IN CANNABIS

The preponderance of cash in the cannabis market, including most notably at the dispensary level, is a result of the conflict between state and federal legal positions on cannabis. This has prohibited many financial services providers from involvement with this burgeoning sector and has, in turn, limited the potential of electronic payment mechanisms. Cannabis remains a Schedule I drug at the federal level, and this has not changed despite state legalization efforts at the medical and adult-use levels. Further, many states' regulations differ at the local level, creating a hodgepodge of compliance considerations. This has created a conflict between local, state, and federal law that remains unresolved, and it is enough to ward most financial institutions away from the market.

Due to the federal scheduling of cannabis, most activities of legal cannabis businesses at the cultivation, production, and distribution levels must remain confined within state lines. Furthermore, cannabis's Schedule I status means that ancillary companies that never touch an actual plant but support the industry, such as business services, real estate, and insurance, are subject to the same restrictions in banking access.

Despite this conflict between state and federal laws on cannabis cultivation, production, distribution, and consumption, several key legal considerations provide a mechanism for financial institutions to become involved in the legal cannabis industry. Several initiatives are also underway to provide clearer guidance to banks on cannabis industry involvement. These key legal initiatives are outlined here:

- **The Cole Memorandum**: The Cole Memorandum was released by then acting attorney general James Cole and was sent to all U.S. attorneys in 2013. It states that the Department of Justice would not enforce federal marijuana prohibition in states that legalized it and that had effective regulatory and enforcement systems in place. Prosecutions would be undertaken where activity undermined federal law enforcement priorities, such as gang activity, violence, distribution to youth, and drugged driving. The Cole Memorandum was formally rescinded by then attorney general Jeff Sessions in 2018, under what is now known as the Sessions Memorandum. Despite the Sessions Memorandum, Department of Justice practices under attorney general William Barr continue to operate as if the Cole Memorandum still stands, with no federal prosecutions of state-compliant marijuana businesses, except where crimes were committed that broke enforcement priorities listed in the Cole Memorandum.

- **FinCEN and suspicious activity report (SAR) filings:** Building on the legal basis of the Cole Memorandum, FinCEN offers guidance to banks that want to work with cannabis businesses. This guidance states that due to federal prohibition of cannabis, banks involved in the sector must file SARs on any activity they have with a cannabis business, even if that business is only loosely aligned to the sector, every 90 days regardless of state laws. SARs fall into one of three categories—marijuana limited, priority, or termination—referring to whether activity is fully state compliant, under investigation, or terminated. FinCEN requirements means that due diligence of potential marijuana banking clients must be extensive and ongoing. Despite the Sessions Memorandum as described, FinCEN has not changed its guidance from the earlier Cole Memorandum.
- **The Secure and Fair Enforcement Banking (SAFE) Act:** The SAFE Act is an ongoing bill that was approved by the House of Representatives in September 2019 and is waiting passage in the Senate. The SAFE Act is intended to codify and provide protection to banks that serve legal cannabis businesses when they are fully compliant with all state laws. Despite growing public support for cannabis legalization, and rare bipartisan support, the bill remains stalled in the Senate, and it is unclear when it may pass.
- **IRS 280E:** IRS 280E is a federal law stating that any business engaging in the trafficking of a Schedule I or II controlled substance cannot take tax deductions. In practice, this means that cannabis businesses have no choice but to pay taxes on all of their expenses and cannot claim them as a tax deduction, except for the exception of some costs of goods sold. In many cases this results in an effective tax rate of 75% to 80%. This limits profitability for cannabis businesses and creates a need for more complex accounting and tax support, which these businesses struggle to receive due to cannabis' Schedule I classification.

While the legal environment in 2020 provides a path for banks to be involved in the legal cannabis sector, due primarily to the Cole Memorandum and FinCEN guidance, most deposit-taking banks in the U.S. today have avoided banking the legal cannabis market, and the industry remains notoriously financially underserviced. For larger-scale banks in particular, with branches and activities that cross state lines, this has diminished their interest in taking part in the market. As a result, the legal cannabis sector lacks access to use a host of banking services, from payments to deposits, loans, insurance, and other areas, and many banks are unable to grow alongside a burgeoning greenfield sector.

Despite the legal and cash-based challenges facing the cannabis industry in the U.S., the market remains rife with opportunity and is poised for continued growth in the near to medium term. The scale and growing sophistication of the legal cannabis market mean that banks willing and able to support the market today are likely to grow with many of these businesses. As the market matures, the number of banks active in the space is likely to continue to increase. And further clarification of the legal environment will ease the challenges for banks working with the cannabis sector. Those banks with a head start in the space are likely to benefit from their existing experience and relationships when the law eventually changes.

THERE IS AMPLE SPACE FOR NEW BANK ENTRANTS

The number of institutions actively banking the legal cannabis market in the U.S. remains low and is likely lower than many market watchers estimate. According to FinCEN's own reporting on SAR filings, there were 739 financial institutions "actively" banking marijuana-related businesses at the end of Q4 2019. Of these institutions, FinCEN reports 559 are banks and a further 180 are credit unions.[7] However, these figures capture the number of banks that have filed SARs in this space and are likely to significantly overstate the true number of cannabis banks in the U.S. This incongruity is driven by a lack of definition on what constitutes a marijuana-related business within a SAR filing, banks filing SARs on businesses incorrectly, and the inclusion of banks terminating relationships in these counts.

Further, many banks active in the space are doing so reluctantly on behalf of existing business clients that wish to enter the cannabis market, such as agricultural companies, commercial landlords, plumbers, or electricians, and as such may only have one or two direct cannabis-related clients. The number of banks proactively servicing cannabis businesses is hence smaller still. Based on conversations with industry experts, Aite Group estimates there are likely fewer than 100 banks and credit unions proactively banking legal cannabis businesses in early 2020. While this number will continue to rise in the near term as the market expands, demand for banking services remains strong, and there is major opportunity for further bank involvement.

Due to the heavy compliance and reporting requirements of cannabis banking, the sector is currently dominated by smaller banks, community banks, and credit unions. These smaller banks and financial institutions are in many instances better suited to work with cannabis businesses due to their agility. However, navigating the regulatory, compliance, and legal requirements for banking and payment services is often challenging for these smaller banks. To address banks' heavy compliance need, an increasing number of services firms, including NatureTrak, Abaca, SpenceLabs, ICS, and Shield Compliance, specifically focus on providing expert platforms and software to help banks that may lack the required staffing resources to do so on their own. As the cannabis market grows and becomes more sophisticated, this will only expand the need for financial services support from a variety of partners.

Aite Group notes that the variety of potential partners for the legal cannabis industry is growing as more entrants join the broader banking and fintech vendor market. The commercial banking sector as a whole is seeing growing activity from new entrants, including the likes of digital-first neobanks and existing fintech vendor unicorns (such as Square) gaining bank licenses or expanding more concretely into commercial payment areas (including Stripe's move into card issuing). Given this broader shift, gaps in service to the legal cannabis sector are unlikely to stay unfulfilled for long.

---

7. "Marijuana Banking Update," FinCEN, December 2019, accessed April 8, 2020, https://www.FinCEN.gov/sites/default/files/shared/291404_1st_Q_FY2020_Marijuana_Banking_Update_Public.pdf.

CANNABIS BANKING IS A REVENUE GENERATOR FOR BANKS

While the regulatory hurdles of cannabis banking, including SARs filings and continual due diligence, are enough to scare off most banking providers, those that are proactive in the sector see significant financial benefit. Alongside the substantial funds and business growth seen by many cannabis-related businesses, institutions banking the cannabis industry are able to generate notable deposits and revenue tracks, including for service fees on deposit accounts. Table A outlines real examples of banks that actively bank the cannabis sector compared to peers of a similar asset size.

Passage of the SAFE Act, descheduling of cannabis from Schedule I, or other legal clarification will likely increase competition in the cannabis banking and payments space, and consequently drive down pressure on these fees. Given the ongoing need for compliance and enhanced due diligence, fees for servicing cannabis businesses are likely to remain higher than for traditional business banking, driving higher bank revenue in this sector in the near term.

Table A: Cannabis Bank Service Fees on Deposit Accounts

Bank	Asset size (in US$ millions)	Service fees on deposit accounts (in US$ millions)	Service fee revenue as a percentage of asset size	State	Cannabis or noncannabis bank
Bank A	$140.2	$2.8	2.0%	Colorado	Cannabis
Bank B	$140.2	$0.3	0.2%	Missouri	Noncannabis
Bank C	$123.3	$2.5	2.0%	Florida	Cannabis
Bank D	$123.3	$0.4	0.3%	Tennessee	Noncannabis

Source: Aite Group, FDIC

MORE ROUTES TO MARKET FOR BANKS

Many banks active in the cannabis banking space prefer overall not to advertise their services, and this can make forming relationships with cannabis businesses difficult. Further, many banks and credit unions struggle to navigate the intricate due diligence and compliance requirements necessary to be active in the space. To help meet these challenges head on, a growing number of third-party organizations and technology vendors that work as intermediaries between banks and cannabis businesses, including licensed dispensaries, are now emerging to help meet compliance requirements and form banking relationships.

Many of these emergent cannabis banking partners are specifically targeting smaller banks that may lack the resources to pursue full compliance for banking cannabis on their own, and this is lowering barriers to entry in the market. Organizations such as Dama Financial, Shield Compliance, SpenceLabs and Hypur aim to offer both payment services that can replace cash and greater automation of compliance requirements for both banks and cannabis businesses. As the technology and business processes inevitably mature in the cannabis space, access to the market will broaden and create further opportunity for bank entry.

CONCLUSION

- The legal cannabis market is dominated by cash due to the Schedule I classification of cannabis. This is deeply problematic from a public health and safety, regulatory, and tax collection perspective, while also limiting the potential for an emerging industrial sector to grow.
- The cannabis market is growing. Already reaching almost US$10 billion in cash sales at the dispensary level alone in 2019, the market is set to see continued growth in the near term and has some way to go before reaching full market maturity.
- Cannabis spending in the U.S. will remain positive despite economic turmoil. In many markets, cannabis retail businesses have been deemed essential businesses and have been allowed to stay open, and the sector may prove to be a countercyclical industry. Aite Group estimates cash spending will grow up to 25% in 2020 to reach US$12.3 billion.
- California remains the largest single-state market with US$3.9 billion in cash spending in 2020, but opportunity is rising in nearly every state. Even medical-only states such as Arizona, with spending of US$717 million, are seeing a surge in spending.
- Growth in the market will be buoyed by growing regulatory liberalization at the state level, the increased use of medical cannabis among an aging population, and new value-added products such as CBD.
- While it’s complicated, there is a legal path for banks wishing to be active in cannabis banking through the Cole Memorandum and FinCEN guidance. The passage of the SAFE Act will greatly enhance the ability of banks to be active in cannabis, and this will lead to many banks entering the space.
- There is ample room for more banks to enter the cannabis market, and the true number of proactive banks is likely only about 100 institutions. Banks with an early start will have an advantage when the legal environment changes and more banks enter the market.
- Growing numbers of third-party fintech vendors and service providers, including NatureTrak, and Abaca are providing the means for banks to access and serve the legal cannabis market more easily through technology-driven compliance and market outreach. Barriers to entry are lowering as a result.

ABOUT AITE GROUP

Aite Group is a global research and advisory firm delivering comprehensive, actionable advice on business, technology, and regulatory issues and their impact on the financial services industry. With expertise in banking, payments, insurance, wealth management, and the capital markets, we guide financial institutions, technology providers, and consulting firms worldwide. We partner with our clients, revealing their blind spots and delivering insights to make their businesses smarter and stronger. Visit us on the web and connect with us on Twitter and LinkedIn.

AUTHOR INFORMATION

Gilles Ubaghs
+1.416.818.1874
gubaghs@aitegroup.com

CONTACT

For more information on research and consulting services, please contact:

Aite Group Sales
+1.617.338.6050
sales@aitegroup.com

For all press and conference inquiries, please contact:

Aite Group PR
+1.617.398.5048
pr@aitegroup.com

For all other inquiries, please contact:

info@aitegroup.com