



Banking Marijuana Requires "Act of Congress"

By Don A. Childears, President/CEO, Colorado Bankers Association

Banking supports government efforts to permit financial services for marijuana businesses despite no big benefit to banking and bankers having mixed attitudes about the marijuana authorizing constitutional amendment in Colorado. Now that pot is legal here as of January 1 we feel an obligation to help make it workable. The state of Colorado can't regulate or tax these businesses when it can't track the money. Marijuana businesses and customers deserve to conduct their legal affairs in a normal fashion. And these cash-heavy businesses pose a risk to public safety. Law enforcement and many others want banking services for this new industry.

Issue – The core issue is that regardless of state law the federal Controlled Substances Act (CSA) prohibits everyone, including banks, from dealing with controlled substances or the proceeds from them – e.g. the cash used in the pot transaction. Several federal laws and regulations preclude banks from banking MJ businesses. In spite of comments by U.S. Attorney General Holder, I believe there is nothing the executive branch can do to change this. The resolution of this requires, literally, an act of Congress, which isn't likely in the near future.

Laws – The federal Bank Secrecy Act requires banks to watch for Anti-Money Laundering (AML) law violations in customers' deposit accounts. Government makes banks its informants by the requiring them to file a Suspicious Activity Report (SAR) to FinCEN, an agency of the U.S. Treasury, regarding a customer's suspicious or potentially suspicious activity. SARs include detailed information about transactions that are or appear to be suspicious for a wide variety of specified activities, to help the government identify individuals and groups involved in fraud, terrorist financing, money laundering, and other crimes. Since pot is illegal under federal law, proceeds from that immediately raise money laundering concerns. Last year, about 1.6 million SARs were filed in the U.S. and 342 people were sentenced to an average of 40 months in prison as the result. Failure to file a SAR can result in criminal and civil penalties, including incarceration for involved employees. In fact, federal law technically says a bank is itself committing money laundering by accepting an MJ deposit.

A Currency Transaction Report (CTR) is required for any transaction exceeding \$10,000 in currency – like a pot shop's deposit. Bank compliance with the voluminous, intense technical requirements and related pitfalls involves huge effort and expense, and the risk of error raises very serious consequences.

The federal Know Your Customer doctrine requires banks to understand their customers' businesses and activities and file SARs and CTRs accordingly, and when the bank's customers engage in federally illegal marijuana activity the bank can suffer severe penalties. That applies even if the customer attempts to disguise the true nature when opening the account as "Susie's Cookies," or treating deposits with Fabreze to mask origins of the cash. The resulting serious compliance issues can create major ramifications for the bank. So the crimes a bank can be charged with include CSA violations, aiding and abetting such, money laundering, racketeering, BSA and AML violations... And often charges can be brought against bank personnel. We won't place tellers and others in that position.

State bank – Some have advanced the idea of a state owned bank as a solution. Yes a state can own its own bank, but the moment it connects to the payment system (checks, ATMs, debit/credit cards, internet banking, wire transfers...) then federal law applies all banking laws and regulations to it. The result is a bank facing the same issues as any other bank. State ownership doesn't help, other than conveniently aggregating pot deposits in one location for federal seizure.

Attorney General's "guidance" – As AG Holder indicated, the executive branch (Treasury and Justice departments) plans to issue "guidance" saying banks won't be prosecuted for such crimes, but that isn't the main worry for banks. We can deal with prosecutors who can put someone in prison for decades, but what really scares a bank is what bank regulators and examiners can do; they have real power! Of the three primary bank regulatory agencies (Federal Reserve, FDIC, Comptroller of Currency), the first two are independent agencies outside of and uncontrolled by the executive branch and they still have a duty to enforce the CSA. They can and will impose various Prompt Corrective Actions like civil money penalties, cease and desist orders, fines, and even banning bankers from their careers for life.

Guidance limits – “Guidance” doesn’t carry the weight of laws, and cannot change the fact that marijuana is against federal law. It can’t change water into wine. Banks need reliability which this guidance can’t provide. Elections can bring a change in guidance. It doesn’t even take that; this anticipated guidance will be the fourth formal position on marijuana from this Department of Justice in the last couple years. Temporary policies don’t cut it. Altering this body of law is both technically and politically complex. We need the permanence only Congress can provide.

Obstacles, green lights – People don’t like their bank taking risk with their deposits or financial transactions. Banking isn’t designed to take risk, and bankers don’t like it. Before any prudent bank would venture into providing services to pot businesses, it would require numerous “green lights,” including from its own legal counsel. To date, banking has seen only “red lights” (Controlled Substances Act, AG & US Attorney interpretations of such, Bank Secrecy Act, Anti-Money Laundering Act, USA Patriot Act, and directives from bank regulatory agencies (Fed, FDIC, OCC)...). AG Holder’s recent statement at best indicates a forthcoming “yellow light” from Treasury. No lawyer I know would conclude that gives the bank a green light in light of related obstacles.

Among green lights banking needs are having detailed in-hand guidance from regulators about legal and regulatory obligations, and a high probability of no action against the bank by bank regulatory agencies on various federal laws/regulations. Other green lights are needed for appropriate internal comprehensive regimens to comply with numerous laws that require special handling and massive reporting on MJ deposits, and to navigate the more complicated area of lending. For existing and new loans related to pot, including loans to third parties (e.g. landlords to pot businesses) there are ugly impacts for the bank. Banks also need a low prospect of prosecution now or in the future, which DoJ is trying to provide. But previous DoJ requirements to avoid federal prosecution have included no sales to minors, a guarantee that pot in a “legal” state does not end up in an “illegal” state, no organized crime involvement, no other illegal drugs, no marijuana activity on federal property, efforts to prevent drugged driving... And an additional needed green light is the low likelihood of litigation by private parties.

Direct obstacles – Direct obstacles to banks regarding pot deposits include money laundering allegations (via branch deposits, ATMs, debit cards, internet banking...); adequate SAR and CTR filings; expensive compliance programs to meet the voluminous, intense technical requirements of various laws and regulations and the risk of minor errors that carry big consequences; “Know Your Customer” considerations on the bank’s liability for illegal acts of legal MJ customers; regulatory criticisms in bank examinations and regulatory actions; criminal prosecution for various crimes; threats to public safety (i.e. robbery of a cash-heavy customer on bank property); potential federal prosecution of bank personnel (tellers) for minor infractions; the bank’s image or reputation...

Banks’ fewer direct obstacles in lending are more complex. There is a risk of federal seizure of collateral that is used in marijuana activities – and collateral not connected to MJ. For example, if a bank customer owns a strip mall and one tenant of the mall is involved in marijuana, technically the entire mall is subject to federal seizure and thus for banking purposes the entire mall is now gone as collateral for the loan. That produces lots of big ramifications. And bank examiners won’t let a bank count income from an illegal activity as income needed to repay a loan. So the customer has a more difficult time qualifying for a loan.

Indirect obstacles – Indirect issues that distress banks include money services businesses (MSBs: cash heavy bank customers like payday lenders, check cashers...) where Know Your Customer requires the bank to have a detailed knowledge of the MSB’s operations and cash flow, non-bank owned/operated ATMs, public entities where comingled deposits include tax/fee revenue from MJ sources, nonbank merchant processors that process debit/credit cards for retailers, other customers that lease or sell to pot businesses, and even other banks that accept MJ deposits and acquire certain services from larger banks, like storing cash in the bigger bank’s cash vault. Under Know Your Customer everyone gets contaminated.

Solution – So despite our desire to promote public safety, facilitate the state’s ability to tax and regulate these businesses and be able to serve marijuana customers and businesses, we believe it literally takes “an Act of Congress” to attract banks to this business in light of complex issues, risks and obstacles. One bill to accomplish this is H.R. 2652 by U.S. Representatives Perlmutter, Coffman, DeGette, Polis and others. In states that have legalized pot it prohibits federal bank regulators from terminating or limiting FDIC insurance (which would put the bank out of business), punishing any bank doing business with pot businesses, discouraging bank business with an MJ entity, or taking any action on a loan or lease because it is a pot business. Governor Hickenlooper also has pressed for an answer. The solution isn’t easy, and we believe only Congress can provide it.

Points Made Above Are in List Form Below

Reasons banks care:

- State of Colorado can’t regulate or tax MJ businesses when it can’t track the money
- Marijuana businesses and customers deserve to conduct legal transactions in a normal fashion
- Cash-heavy businesses pose a risk to public safety

Federal laws that preclude banking marijuana businesses:

- Controlled Substances Act (CSA) prohibits everyone, including banks, from dealing with controlled substances or the proceeds from them (cash used in buy pot)
- Bank Secrecy Act (BSA) requires banks in the U.S. to assist government agencies to detect and prevent money laundering
 - Government makes banks its informants by the requiring them to file a Suspicious Activity Report (SAR) regarding a customer’s suspicious or potentially suspicious activity. SARs include detailed information to help the government identify individuals and groups involved in fraud, terrorist financing, money laundering, and other crimes
- Anti-Money Laundering (AML) law prohibits individuals from engaging in a financial transaction with criminal proceeds and concealing the source, ownership or control of the funds – requiring banks to monitor and report suspected violations in customers’ deposit accounts
 - Currency Transaction Report (CTR) is required to the government for any transaction exceeding \$10,000 in currency
- Know Your Customer (KYC) doctrine requires banks to understand their customers’ businesses and activities and file SARs and CTRs accordingly, even when the customer attempts to disguise the true nature of funds

Reasons “guidance” is ineffective:

- Cannot change the fact that marijuana is against federal law; it can’t change water into wine
- Doesn’t apply to two of three bank regulators that are independent agencies uncontrolled by the executive branch but still with a duty to enforce the CSA – extensive power to impose various penalties
- Doesn’t have needed reliability; elections can change guidance, and anticipated guidance will be the fourth formal position on marijuana from this Department of Justice in the last couple years

“Red” lights to date:

- Various laws and regulations: Controlled Substances Act, Bank Secrecy Act, Anti-Money Laundering Act, USA Patriot Act, Know Your Customer...
- Attorney General and US Attorney interpretations of those laws threatening prosecution for “aiding and abetting” violations of above laws
- Directives from bank regulatory agencies (Fed, FDIC, OCC) on compliance with those laws

Possible “yellow light” (yellow at best):

- Attorney General Holder’s recent statement and anticipated guidance from Treasury

Needed “green” lights:

- 1) Detailed in-hand guidance from regulators about legal and regulatory obligations
- 2) Low likelihood of criticisms in bank examinations and resulting regulatory actions on various federal laws/regulations
- 3) Appropriate internal comprehensive regimens to comply with numerous laws that require special handling and massive reporting on MJ deposits
- 4) Low prospect of prosecution now or in the future for various crimes (DoJ is trying to provide) – past DoJ pronouncements required no sales to minors, a guarantee that pot in a “legal” state does not end up in an “illegal” state, no organized crime involvement, no other illegal drugs, no marijuana activity on federal property, efforts to prevent drugged driving...
- 5) Acceptable SAR and CTR filing procedure
- 6) Low risk of minor SAR/CTR errors that carry big consequences
- 7) Acceptable compliance program to meet the voluminous, intense technical requirements of various laws and regulations
- 8) Probability “Know Your Customer” protocol is adequate to avoid liability for illegal acts of customers
- 9) Low concern about threats to public safety (i.e. robbery of a cash-heavy customer on bank property)
- 10) Low likelihood of litigation by private parties
- 11) Advice from legal counsel that banking marijuana is permissible

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