MARIJUANA BANKING
ISSUE BRIEF

NAFCU

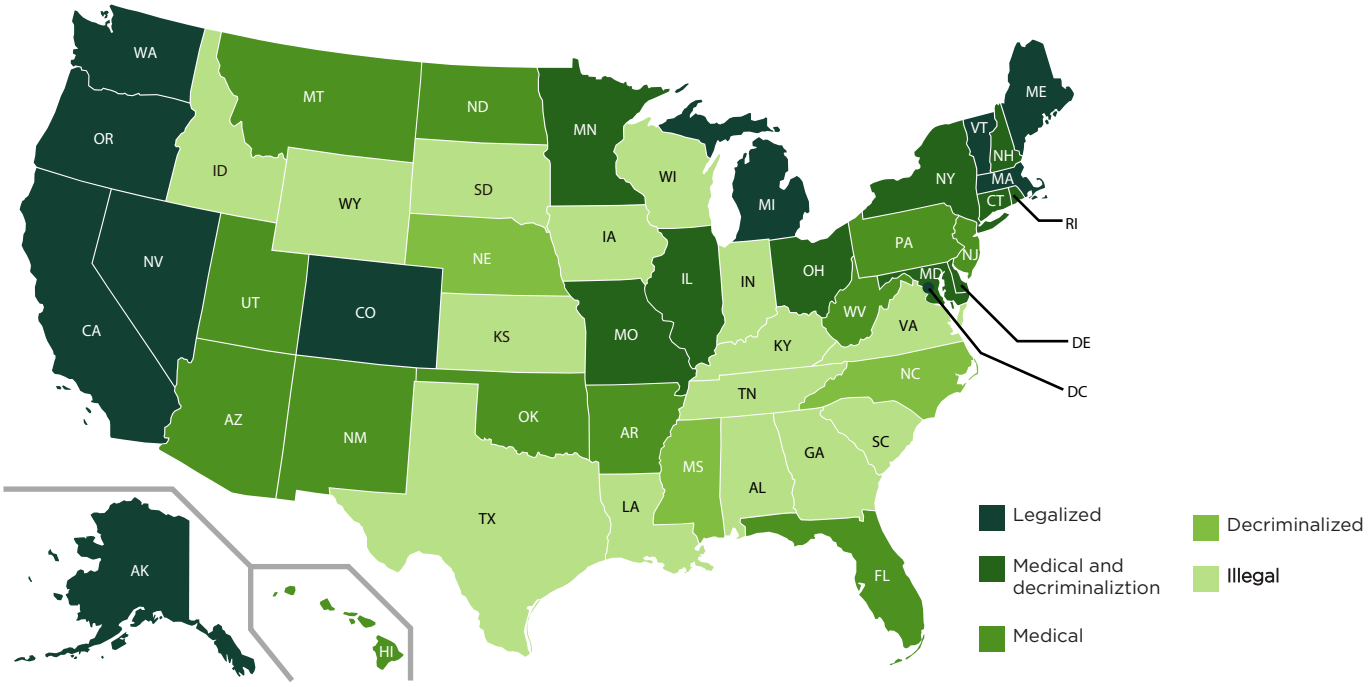
National Association of Federally-Insured Credit Unions

BACKGROUND

In 2017, the marijuana industry was an estimated $8.5 billion, and it's projected to reach over $23 billion by 2022. Medical marijuana is now legal in 33 states with 10 of those states legalizing recreational marijuana, although Vermont and Washington D.C. prohibit the sale of marijuana. Some states, including North Carolina, Mississippi, and Nebraska, have decriminalized marijuana. Despite varying levels of legalization at the state level, marijuana continues to be illegal at the federal level. Marijuana is categorized as a Schedule I substance under the *Controlled Substances Act* (CSA); defined as having no currently accepted medical use and a high potential for abuse or misuse. Besides the CSA, there are additional criminal provisions under federal money laundering statutes, unlicensed money remitter statutes, and the *Bank Secrecy Act* (BSA). To illustrate, any financial transaction involving proceeds generated by "marijuana-related conduct" could subject a credit union to prosecution under the money laundering statutes, the unlicensed money transmitter statutes, and the BSA. Further, if a credit union makes transactions by or through a money transmitting business where the funds were "derived from" marijuana-related activity, then that could be the basis of prosecution under the unlicensed money transmitter statues. The conflicts between current state and federal laws leave credit unions uncertain whether they should provide services to marijuana-related businesses (MRBs). In 2017, it was estimated that one-third of marijuana businesses could not obtain a bank account.

Marijuana Laws in the US

Note: Vermont and Washington, DC, do not allow marijuana sales for recreational purposes



Source: Marijuana Policy Project

LEGISLATIVE OUTLOOK

NAFCU is not taking, and will not take, a position on the broader question of legalization or decriminalization of marijuana at the state or federal levels. However, NAFCU does support legislative steps to provide clarity and legal certainty to the question of whether financial institutions may safely allow state-authorized MRBs to have access to their services. Legislation from the 115th and 116th Congresses that addresses these issues in part includes, but is not limited to:

- The Secure and Fair Enforcement (SAFE) Banking Act. This bipartisan bill, H.R. 1595, by Reps. Ed. Perlmutter (D-CO), Denny Heck (D-WA), Steve Stivers (R-OH), and Warren Davidson (R-OH), would align federal and state laws concerning MRBs and their access to banking services by prohibiting federal banking regulators from engaging in adverse actions against financial institutions. The House Financial Services Subcommittee on Consumer Protection and Financial Institutions held a hearing on a draft of the bill on February 13, 2019 and the full Committee held a mark-up of the bill on March 26, 2019. A similar bill was introduced in the 115th Congress but did not receive a hearing or mark-up.
- S.421 – the Responsibly Addressing the Marijuana Policy Gap Act of 2019. Introduced by Senate Finance Committee Ranking Member Ron Wyden (D-OR), this bill includes, among other things, a section dedicated to legislative protections for financial institutions doing business with MRBs similar in fashion to the SAFE Banking Act.
- The Strengthening the Tenth Amendment Through Entrusting States (STATES) Act. Introduced during the 115th Congress by Sens. Cory Gardener (R-CO) and Elizabeth Warren (D-MA) and Reps. Earl Blumenauer (D-OR) and David Joyce (R-OH), this bicameral and bipartisan bill would exempt federal enforcement against individuals acting in compliance with state laws. Additionally, to address financial issues caused by federal prohibition, the bill states that compliant transactions are not trafficking and do not result in proceeds of an unlawful transaction. The STATES Act has not been reintroduced in the current Congress.

Although NAFCU has not endorsed a specific legislative proposal, we do support Congress examining what legislative steps can be taken to provide greater clarity and legal certainty at the federal level for credit unions that choose to provide financial services to state-authorized MRBs and ancillary businesses in states where such activity is legal. Even though not a total solution, a strong safe harbor for financial institutions that wish to serve such businesses would be one step toward improving clarity and addressing what is often perceived as misalignment between federal and state laws. We are pleased to see legislation that takes steps toward this goal; however, Congress should continue to examine all possible solutions in this area.

REGULATORY LANDSCAPE

The regulatory landscape is constantly changing as the marijuana industry evolves and more states seek to legalize either medical or recreational marijuana use. Moreover, with the shifting of leadership at various agencies and departments of the executive branch, guidance has been both loosened and pulled back in recent years. This has created a patchwork of considerations to weigh for credit unions that are determining whether to offer financial services to MRBs. It is possible that a credit union may be unknowingly providing financial services to a MRB if their member is providing ancillary services or products to a MRB. The guidance governing MRBs affects credit unions broadly in this case, and not just those who expressly choose to service MRBs. The uncertainty of the regulatory environment creates complexities for credit unions, and barriers and instability for those MRBs seeking financial services.

A brief background and explanation of guidance from each agency is listed below.

Department of Justice & Financial Crimes Enforcement Network

In 2013, the Department of Justice (DOJ) issued guidance in what is commonly known as the "Cole Memo." The Cole Memo did not alter the criminality of marijuana or address marijuana banking, but instead laid out the enforcement objectives of the DOJ and attempted to reduce prosecution of marijuana offenses by determining a priority for those offenses. The DOJ outlined the following eight enforcement priorities:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

Anything that falls outside of the DOJ's listed priorities would be handled by state and local law enforcement agencies, pursuant to their applicable state laws. This guidance was prompted, in part, by the legalization of marijuana at the state level; however, the

guidance did not specifically address applicability to financial institutions, or financial crimes involving marijuana-related funds.

In 2014, a second Cole Memo was published to address DOJ enforcement of money laundering and laws under the Bank Secrecy Act (BSA), including the filing of Suspicious Activity Reports (SAR). The second Cole Memo stated that if a financial institution or individual provided banking services to a MRB that engaged in any of the activities outlined in the eight priorities listed in the first Cole Memo, that financial institution or individual could be subject to federal prosecution. The second Cole Memo also emphasized that financial institutions that chose to serve MRBs in a state that is not compliant with state regulatory and enforcement systems, or operates in a state that lacks a clear and robust regulatory schedule, are at a greater risk for federal prosecution. Lastly, the DOJ reiterated that financial institutions must adhere to the Financial Crimes Enforcement Network (FinCEN) guidance that was issued concurrently with the second Cole Memo.

FinCEN issued guidance in 2014 regarding the BSA expectations for banking MRBs. This guidance included establishing best practices for customer due diligence (CDD), a SAR filing structure, and ways to identify MRB red flags. Issued concurrently with the second Cole Memo, and the two were intended to supplement one another. FinCEN's guidance provided that CDD for MRBs included:

- Verifying with state authorities that the business is duly licensed and registered;
- Reviewing of the business license application and related documentation;
- Requesting from state licensing and enforcement authorities any available information about the business;
- Developing an understanding of the normal and expected activity for the business, including the types of products sold and types of customers served;
- Performing ongoing monitoring for suspicious activity; and
- Refreshing information as obtained as part of CDD on a periodic basis and commensurate with the risk.

FinCEN's guidance provided that BSA regulations require the filing of a SAR when a financial institution knows, suspects, or has reason to suspect that a transaction: (1) involves funds derived from illegal activity or is an attempt to disguise funds derived from illegal activity; (2) is designed to evade regulations promulgated under the BSA; or (3) lacks a business or apparent lawful purpose. SAR reporting for MRBs is categorized under three key phrases that denote the type of activity involved: (1) marijuana limited; (2) marijuana priority; and (3) marijuana termination. The filing of a SAR is required at the time of account opening and every 90 days thereafter. Those financial institutions that do not implicate one of the eight Cole Memo priorities should file a marijuana

limited SAR. If a financial institution provides services to a MRB that does implicate one of the eight priorities, then a marijuana priority SAR should be filed. In cases where a financial institution deems it appropriate to terminate a relationship with a MRB to effectively carry out its anti-money laundering compliance program, then the financial institution should file a marijuana termination SAR.

According to FinCEN's Marijuana Banking Update (dated September 2018), 486 depository institutions, including 111 credit unions, were providing banking services to MRBs as of September 30, 2018. FinCEN's data also indicated that it received a total of 67,024 SARs using the key phrases associated with MRBs. Of the total amount of SARs filed, 49,743 contained the phrase "marijuana limited," indicating that none of the eight Cole Memo priorities were involved; whereas, 4,974 SARs filed contained the phrase "marijuana priority," indicating that one of the eight Cole Memo priorities were implicated. The remaining SARs filed contained the phrase "marijuana terminated." Between 2014 and 2018, "marijuana limited" SAR filings saw the largest increase. This data illustrates that the majority of SARs filed do not implicate the Cole Memo enforcement priorities.

Depository Institutions (by type) **Providing Banking Services to Marijuana Related Businesses**
(Data ending 30 September 2018)

Source: FinCEN

In January 2018, former U.S. Attorney General Jeff Sessions rescinded both Cole Memos and directed all U.S. Attorneys to use "previously established prosecutorial principles" for marijuana enforcement. Attorney General Sessions recognized the DOJ's finite resources and directed prosecutors to weigh all relevant considerations, including

federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community. Despite this rescission, FinCEN's 2014 guidance remains intact, leaving the industry to face an uncertain future because on the one hand, you have a financial regulator allowing the banking of a MRB, but on the other hand you could face federal prosecution by the DOJ.

To date, the DOJ has not taken action against a financial institution for banking a MRB after the rescission of the Cole Memos. Attorney Jeff Sessions resigned in November 2018, which could lead to new DOJ guidance regarding marijuana banking, and perhaps a re-installation of the previous Cole Memos. During his confirmation hearing, now Attorney General William Barr stated that he would uphold the Obama-Era Cole memoranda and not "go after" people and businesses that relied on the memoranda.

In written responses to questions from senators, Barr said that although he "has not closely considered or determined whether further administrative guidance would be appropriate," he would carefully consider the matter. He also called for the approval of more legal growers of marijuana for research purposes and noted that the *Hemp Farming Act* has broad implications for the sale of marijuana products across the country. Barr noted that to fully address the differences between state and federal marijuana laws, Congress must act and such legislative action, instead of administrative guidance, is "ultimately the right way to resolve whether and how to legalize marijuana." Barr's perspectives on the issue mark a substantial deviation from the Jeff Sessions DOJ's hard line approach to cracking down on marijuana and MRBs and could signal a return to the Obama-era "hands off" approach. Barr was confirmed as the new Attorney General on February 14, 2018, but until he takes action on this issue uncertainty still persists.

Treasury Department

Although FinCEN is a bureau of the Treasury Department (Treasury), Treasury Secretary Steven Mnuchin has expressed that the Treasury is "reviewing the existing guidance" as the administration considers whether to revoke FinCEN's 2014 guidance. Mnuchin stressed the importance of not rescinding the guidance without a replacement policy in place. In addition, Mnuchin noted that the Treasury wants to ensure that it can collect necessary taxes on the profits of MRBs. In his February 2018 testimony before the House Financial Services Committee, Mnuchin addressed concerns regarding public safety as a result of unbanked MRBs: "I assure you that we don't want bags of cash." Further, Mnuchin noted in his February 2018 testimony before the House Ways and Means Committee that addressing MRBs access to banking remains at the "top of the list" of the department's concerns.

Small Business Administration

Small businesses across the country may be providing products and services to MRBs either knowingly or unknowingly in an ancillary capacity. In an effort to address concerns raised, the Small Business Administration (SBA) issued a policy notice in April 2018 regarding businesses involved with marijuana and their eligibility for SBA financial assistance - including obtaining 7(a) and 504 loans. The SBA's policy provides that those businesses engaged in any illegal activity, either federal or state, would be ineligible for SBA financial assistance. This includes businesses that derive revenue from MRBs, or support the end-use of marijuana, including sellers of marijuana.

Ineligible businesses are those that fall into one of the following three categories: (1) direct marijuana businesses; (2) indirect marijuana businesses; and (3) hemp-related businesses. "Direct marijuana businesses" include growers, producers, processors, distributors, or sellers. "Indirect marijuana businesses" are those businesses that derive any of their gross revenues in the previous year from sales to direct marijuana businesses. Examples include businesses that provide lights or hydroponic equipment. Lastly, those businesses that are "hemp-related businesses" such as growers, producers, processors, distributors, or sellers of hemp products. Unless the business can demonstrate that the products or services are legal under federal and state law, they remain ineligible for SBA financial assistance.

In addition, the SBA's policy notice provides guidance on SBA-guaranteed loan proceeds being utilized for the leasing of a building for a business engaged in marijuana related activities. The SBA advises lenders that during the life of the SBA-guaranteed loan, a borrower **cannot** lease a building to one of the ineligible businesses listed in the policy. The underlying property is at risk for seizure, as the payments on the SBA loan would be derived from illegal activity.

POLITICAL LANDSCAPE

Marijuana banking is a polarizing issue that has yet to gain overwhelming support in Congress. To date, there has not been a serious effort at the federal level to remove marijuana from its Schedule I classification under the CSA. Even more narrow efforts to assist MRBs have not been successful. In June 2018, the Senate Appropriations Committee, in a 21-10 vote, tabled an amendment to a broader budget bill that would have shielded from liability financial institutions that open accounts for MRBs that are complying with state laws. Around the same time, the House Appropriations Committee defeated a similar marijuana banking proposal.

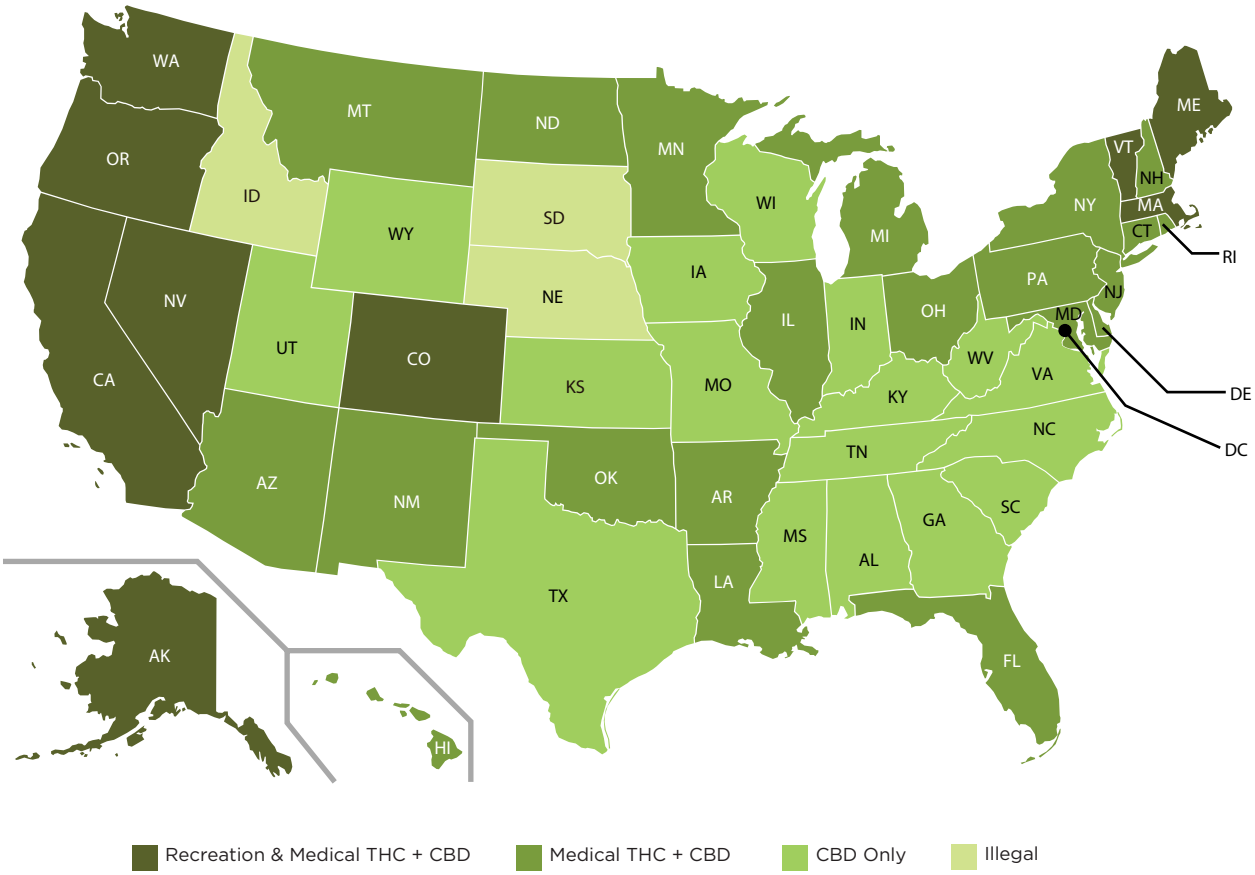
With Democratic control of the House, the odds have increased that we may see legislation advance that could provide a safe harbor for financial institutions to serve MRBs or provide greater clarity on marijuana policy at the Federal level as it impacts states that have legalized marijuana to varying degrees. On March 26, 2019, House Financial Services Committee Chairwoman Maxine Waters held a Committee mark-up of the latest version of the SAFE Banking Act (H.R. 1595).

Senate Banking Committee Chairman Mike Crapo outlined the committee's agenda for the 116th Congress, and marijuana banking was noticeably absent from the agenda. Despite this exclusion on the committee's agenda, marijuana banking could still be included as part of a larger bill. For example, the SAFE Banking Act could be reintroduced as part of a broader financial policy bill or a spending bill. Alternatively, the SAFE Banking Act or the STATES Act could be reintroduced in the Senate at some point during the 116th Congress.

Prior to the beginning of the 116th Congress, the *Hemp Farming Act* was included as part of the Farm Bill (with the support of Senate Majority Leader Mitch McConnell), which was passed and signed into law in December 2018. This included an important change to the CSA, removing hemp-derived products from Schedule I substance classification under the CSA. The definition of marijuana previously included hemp and hemp byproducts such as cannabidiol (CBD). This now allows hemp cultivation, the transfer of hemp-derived products across state lines for commercial purposes, and imposes no restrictions on the sale, transport, or possession so long as the help is produced in a manner consistent with the law.

Hemp will still remain regulated, and restrictions are still imposed, such as a THC threshold level that cannot exceed more than 0.3 percent, and states will possess the power over licensing and regulation with the assistance of the United States Department of Agriculture (USDA). Further, any CBD that is hemp-derived may also be legal under this definition, but those that are not would still remain illegal as a Schedule I substance. This legislative change illustrates the possibility of further modification of the definition of marijuana in the CSA, and could signal a change in Congress's appetite in providing clarity on marijuana policy. The map shows the variations among state rules regarding hemp and CBD.

State Cannabis Programs



Source: **NORML** (The National Organization for Reform of Marijuana Laws) Data reflects regulations for marijuana. the legality of shipping CBD across state lines is ambiguous. This information for educational purposes and is not legal advice. Updated as of December 7, 2018.

LITIGATION

After a lengthy legal battle with the Federal Reserve Bank of Kansas City, on February 7, 2018, the Federal Reserve granted Fourth Corner Credit Union conditional approval of its master account application. The conditions included obtaining share deposit insurance from the NCUA, and an amendment to the bylaws stating that Fourth Corner would not serve MRBs directly until doing so becomes federally legal. Fourth Corner subsequently decided to serve supporters of marijuana legalization which could include trade associations that support the marijuana industry. Until recently, Fourth Corner was also involved in litigation with the NCUA. On June 25, 2018, the U.S. District Court for the District of Colorado denied Fourth Corner's motion to compel mediation with the NCUA and dismissed the case. The court held that Fourth Corner's case is moot because the credit union agreed to not serve MRBs and must now simply reapply for share insurance from the NCUA, so the court can no longer redress a harm to the credit union.