The changing legal landscape for marijuana use puts banks in several difficult spots

By Megan Michiels

A national conversation and policy discussion about the business of marijuana is taking place right now, and the eventual outcome will be important to the banking industry. What has long been seen as a criminal issue has now become a business issue, too.

If your bank is not operating in a state where marijuana has been legalized, that could change soon. Twenty states and the District of Columbia allow some use of medical marijuana; Colorado and Washington have gone further and legalized recreational use (see table). On Jan. 1, 2014, state-licensed retailers in Colorado opened to sell marijuana to anyone 21 years old or older. Retail sales in Washington are expected to begin later this year.

The trend among states shows no sign of reversing. Medicinal-use bills have been filed in Kentucky, Minnesota, Pennsylvania, Tennessee, and Wisconsin. Medicinal-use bills are expected to be introduced in
Maryland, West Virginia, and Wyoming. Full-legalization bills have been introduced in New Hampshire and Vermont. New York Governor Andrew Cuomo announced he would sign an executive order authorizing an interim medical marijuana program. California Lt. Governor Gavin Newsom is leading a panel studying how the state can tax and regulate a fully legalized marijuana market.

Regardless of state initiatives, marijuana remains illegal under the federal Controlled Substances Act. Financial institutions that knowingly accept proceeds from marijuana transactions may be exposed to civil and criminal liability. To avoid federal scrutiny or risk prosecution, banks have refused to accept business from the marijuana industry.

Consequently, state-sanctioned marijuana enterprises are becoming cash-only operations without access to banking services. The unbanked dollars are considerable. Marijuana vendors in Colorado sold approximately $1 million of product on the first day the drug was available for retail sale. According to ArcView Market Research, nationwide “legal” marijuana sales exceeded $1.4 billion in 2013 and are estimated to reach $2.3 billion in 2014.

**Federal and state barriers**

Even if banks are willing, they face significant risk if they offer banking services to marijuana-related businesses. The federal statutory barriers include the Controlled Substance Act, USA Patriot Act, Bank Secrecy Act, and the Racketeer Influenced and Corrupt Organizations Act.

In Congress, the Marijuana Businesses Access to Banking Act of 2013 (H.R. 2652) was introduced by Rep. Ed Perlmutter (D-Colo.). The bill would create protections for depository institutions that provide financial services to marijuana-related businesses authorized under state law. The bill currently has 24 cosponsors from 12 states, but has not made it out of committee.

A state-level solution proposed by Washington State Senator Bob Hasegawa would create a publicly owned state bank to serve the marijuana industry. However, a state-owned bank that knowingly violates federal narcotics and money laundering laws could not hold FDIC insurance and would, therefore, be prohibited from accessing payments systems overseen by the Federal Reserve.

**So far, mostly uncertainty**

The calls for clarity on how to navigate this uncharted territory are mounting from businesses, politicians, and bankers. In October 2013, Colorado Governor John Hickenlooper and Washington Governor Jay Inslee asked federal financial regulators for interagency guidance to enable the banking industry to legally offer banking services to state marijuana licensees. In their letter, the governors point out that, “Access to the banking system by these state-licensed businesses is a necessary component in ensuring a highly regulated marijuana system that will accurately track funds, prevent criminal involvement, and promote public safety.”

Marijuana-derived fees and taxes are collected and deposited into governments’ banks accounts. It has been asserted that government deposits of marijuana-related funds are not subject to federal seizure, because tax money is legal even if the proceeds are derived from an illegal activity—but this is not entirely clear. Institutions with municipal- and state-client accounts would benefit from assurance that they can continue to bank government accounts that include marijuana-related deposits.

Speaking at the American Bankers Association/American Bar Association Anti-Money Laundering Enforcement Conference in November 2013, Financial Crimes Enforcement Network Director Jennifer Shasky Calvery acknowledged the predicament and complexity of the issue. Director Shasky Calvery stated that discussions amongst the Department of Justice, Department of Treasury, and...
other financial regulators are underway to seek a resolution.

In December 2013, the Bank Secrecy Act Advisory Group (BSAAG) held a meeting to begin talks on reforming banking regulations to allow banks to engage in services in the marijuana business. The advisory group is a task force comprised of officials from Treasury, Justice, federal and state regulators, and industry participants, including the ABA. BSAAG meetings are confidential.

The outcome of such discussions remains uncertain. At this stage, a guidance memorandum for marijuana-related businesses and banking seems the most probable.

According to the Wall Street Journal, the Department of Justice is drafting a memorandum to federal prosecutors that will provide some guidance for financial institutions. It is expected that the guidance will prioritize financial enforcement efforts on transactions that serve as a front for other illegal activity or are a part of larger drug cartel activities. However, it appears unlikely that a memorandum along these lines will clearly immunize banks.

**Where does all this leave banks?**

Regulatory guidance would be helpful, but alone it is unlikely to quash banker woes about the legal consequences of servicing marijuana businesses. As long as federal statute classifies marijuana as a controlled substance, the risk of criminal charges and seizure of assets associated with these businesses is a significant deterrent to the banking industry to take on, as clients, those in the budding market.

Banks are faced with complying with the law and determining how to best protect the interests of their institutions. Banks may want to review and verify personal and business customer account rolls to assure that no prohibited relationships exist. However, it is conceivable that marijuana businesses have open and active bank accounts without explicit knowledge of the financial institution. Recent press articles have highlighted instances of marijuana businesses' reliance on preexisting accounts or even deceptive tactics to access banking services. Presumably though, bank compliance with the due diligence requirements and their responsibilities for maintaining systems designed to detect and report suspicious activities would uncover these deceptions.

Banks will want to consider the potential impact on their interests or operations if a marijuana business has some connection to an existing customer. It would be useful to address this before a critical decision must be made or before a bank loses the collateral that secures a loan.

Banks may want to review existing loan collateral, particularly in real estate transactions. Financial institutions cannot lend against inventory or receivables that are illegal. For example, if a commercial mortgage is secured by a shopping center, a lease to a marijuana dispensary could leave the entire loan effectively unsecured. In the fall of 2011, federal prosecutors in California notified real property owners, landlords, and lenders whose loans were secured by real property occupied by medical marijuana dispensaries that under federal law their real and personal property interests were subject to seizure and forfeiture without compensation and free from a lender's lien interest in the property. If possible, institutions may consider amending loan documents or security interests to include representations and warranties that no federally illegal drugs are grown, sold, or used on the property or in connection with the loan funds.

**Things to consider**

Things could get complicated fast if banking access opens up to the marijuana industry. Maintaining adequate risk management policies, reviewing existing products, and adapting employment practices are just a few of the concerns for banks. They also should review policies to ensure federal laws are not violated and to avoid additional regulatory scrutiny. Also, banks may need to implement additional compliance procedures if new rules are required to transact with marijuana businesses.

Institutions also may need to review existing procedures for some of their traditional banking products. Take, for example, a small business loan to a marijuana shop. A typical loan would be secured by the store's inventory and accounts receivable. In the case of marijuana inventory, a bank will have to determine if it will accept marijuana inventory and proceeds as collateral. This also raises questions in the event of default of whether a bank would need to be licensed to repossess and resell the inventory.

Disclaimer: This information does not provide, nor is it intended to substitute for, professional legal advice.

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