WASTED OPPORTUNITY

Banks forced to sit on the sidelines of profitable new cannabis industry

By Sarah Wheeler
The legal marijuana business is booming — worth $5.53 billion in 2013, and projected to grow to $15.9 billion in the next five years, according to a 2013 report by ArcView Market Research. Twenty states have approved marijuana for medical use, and eight more have pending legislation on the books. Colorado and Washington have legalized marijuana for recreational use, with more states showing significant interest.

Billions of dollars in new markets should mean a windfall for banks, right?

No, in this case. The fact that state laws conflict with federal anti-money laundering statutes means banks are prohibited from offering services to businesses who sell pot, or to employees of those businesses. As financial firms seek to diversify their operations outside of the lucrative mortgage sales, banks are forced to sit on the sidelines of a profitable new industry. “Basically, banks that offer services to these businesses risk prosecution from the state and federal law enforcement officials,” said Bob Row, vice president and senior counsel for the American Bankers Association.

And banks that expect states have taken that risk — refusing to open accounts for businesses or individuals connected to the industry, and closing accounts at the slightest sign of money from the trade. In other words, following the string of federal anti-money laundering laws that go back to the Bank Secrecy Act (BSA) of 1970. Every bank that was contacted for this story either declined to comment or released a statement similar to this from Wells Fargo: “While new state laws will permit marijuana businesses in Colorado and Washington, and medical marijuana dispensaries are legal in some states, the practice is still illegal under federal law. Our policy of not banking marijuana businesses is based on applicable federal laws and our own assessment of our responsibility.”

When states make emergency services inaccessible, as in Article VI of the Constitution, the federal government has the final say. Unless the federal government decides not to enforce the federal law, having clients that sell pot means banks are in a no-win’s position.

Last August, after voters elected to legalize in Colorado and Washington, the Department of Justice released a memo updating its enforcement policy for marijuana production, processing and sale that was initially choreographed by proponents of the state laws, but quickly proved to only muddy the waters regarding regulation. It outlined the division as a “professional priority,” leaving state and local enforcers to enforce (or not enforce) the law.

These eight areas include preventing the distribution of marijuana to minors and other users whose use is unlawful, and preventing it from being sold for illegal purposes. These are particularly relevant for banks and others in the financial sector:

- Preventing revenue from the sale of marijuana from going to criminal enterprises, which would be illegal under the law.
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal acts.
- Ensuring compliance with state and local laws.
- Providing a source of revenue for schools and other state institutions.
- Providing a source of revenue for local governments.
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Bassically, money laundering.

But even if banks were barred from these eight areas, the DOJ letter made that clear in trouble. “Finally, nothing herein pretends precludes investigation or prosecution, even in the case of any of the factors listed above, in particular circumstances wherein the investigation and prosecution otherwise serve an important federal interest.”

This kind of cover is big enough to drive a truck through, and banks responded accordingly. “Obviously what the Department of Justice and Treasury intended was for these businesses to start accessing banking on a broader scale, but the banks for the most part are reluctant to step up and provide services,” said Taylor Wex, deputy director of the National Cannabis Industry Association.

Meanwhile, without banking services, legal marijuana businesses are operating on a cash basis, transporting their money in rolls of twenties and hundreds in everything from large suitcases to armored cars, Wex said.

“At the end of the work day these businesses are trying to move cash off the premises to a secure location, sending multiple people out of the building at the same time, or using deputy cars to go in different directions,” Wex said.

This puts the legal businesses in a dangerous position to be targeted for robbery, or conversely, to commit theft on a grand scale. Indeed, if breaking bad were set in today’s Colorado or Washington, there would be no need for Walter to operate a car wash to filter his meth money.

The current situation is an anomaly because it forces the industry to be all cash,” said Rep. Earl Blumenauer, D-Ore., who supports a change in the federal law. “It is lunacy because it promotes tax evasion, money laundering.”

While the Drug Enforcement Agency tries to figure out how to separate the good players from the bad, and state and local governments reap a financial windfall by taxing the legal marijuana businesses, banks are caught in the middle.

In an effort to make things clearer, the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) issued a guidance letter in February to banks.

“FinCEN guidance clarifies how financial institutions can provide services to marijuana-related businesses that are not illegal under federal law. Our policy of not banking marijuana businesses is based on applicable federal laws and our own assessment of our responsibility.”

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If only. Rather than providing a solution, the guidance set off a firestorm among banking groups and on Capitol Hill.

FinCEN’s guidance addressed the concern that banks need to apply to their dealings with these businesses and outlawed activity. Suspicious Activity Reports that banks would need to file in certain cases. It also limits a number of “red flags” for banks to look out for.

The Colorado Bankers Association (CBA) issued a scathing press release that opened by stating, “The guidance issued today by the Department of Justice and the Treasury only reinforces and reiterates that banks can be prosecuted for providing accounts to marijuana-related businesses.”

Don Childeers, CRA’s president and CEO, said, “After a series of red lights, we expected this guidance to be a yellow one. This isn’t how to do nothing or just do something. It is nothing but right for banks. This ignores the facts, disregards the law, and makes navigating this industry impossible.”

Don’t expect that to change.

The CBA press release also pushed back against FinCEN’s guidance to banks about “the diligence necessary to ensure that financial institutions truly understand the mission of the agency,” and that it was “dangerously misleading.”

The senators’ letter asked FinCEN to answer eight questions “to help Congress, financial institutions, and the American public understand both the basis and the real-world implications of FinCEN’s guidance.”

The list of questions challenges FinCEN’s authority to give guidance that goes far beyond what the law permits, and serves as a chilling influence of all that could go wrong for banks.

FinCEN answered the senators’ questions on May 8, (see below), appealing to backpedal on most of the initial guidance. The answer did nothing to mollify Congress or FinCEN. FinCEN released a statement that “Although federal law is unclear about regulating marijuana, enforcing marijuana laws at the state level does not impede the ability of financial institutions to serve marijuana-related businesses.”

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Quinones: Medical University found 46% of Florida votes across all ages ranges support the idea of legalizing marijuana for medical use. States looking at Colorado’s tax benefit from its legal trade have plenty of incentive to stay legal. Colorado collected $3,1.4 million in taxes and fees from the legal trade in January alone, and expects that to $1.64 million in taxes in the first six months of its legalization. “This industry is going to grow exponentially in the next couple of years, and there’s an opportunity in the financial services industry to have hundreds of new clients,” Blumenauer said. “It’s naive to think that there aren’t dozens if not hundreds of people right now who are using bank accounts surreptitiously in this business, which poses problems to banks with compliance.”

West said that some banks do find ways to service clients, albeit on a very limited scale. “Some parts of the industry have been able to work with banks if they aren’t directly handling product – be providing consulting services, equipment, etc.”

But attracting even more regulatory interest in their bank at a time of already intense scrutiny is unlikely to appeal to most banks, according to AAA’s Rose. “As the attention on the issue continues, and as it becomes readily apparent that banks run risks associated with any kind of bank service for a marijuana business, the focus has moved from direct relationships with marijuana businesses to any related connection,” Rose said.

“In this instance, where the employee of a marijuana business is earning income from what federal law still classifies as illegal, then accepting mortgage payments from that individual could be deemed money laundering in the eyes of an eager housing prosecutaor. As a result, banks are starting to steer clear and even close out those relationships.”

That last opportunity for banks is also bad news for those businesses trying to pay employees, utility bills and even taxes in cash. “There is a real concern that people aren’t going to take this seriously until someone gets killed,” West said. “Even people who are not comfortable with the whole idea of a legal, regulated cannabis industry can see that there is no actual benefit to being these businesses to operate outside the banking system.”

Blumenauer agreed. “There are still hundreds of businesses caught in the shadows the better off everybody is going to be.”

For banks eyeing a potential golden goose in 23 states, the solution can’t come soon enough.