Insight

Marijuana Banking: A Primer

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Executive Summary

- The legal marijuana industry grew to $10.4 billion in 2018, yet because of the different legal classification of marijuana at the federal and some state levels, an increasing number of businesses in this sector lack access to banking services.
- The current federal regulatory framework makes financial services for marijuana businesses difficult to obtain, forcing the businesses to use cash or turn to alternative financing options or foreign banks.
- While a regulatory safe harbor exists in part for banks, this guidance does not have the certainty of law. Congress can provide that certainty by codifying the federal government's approach to regulating banking services for marijuana businesses.

Legitimate Businesses Without a Bank

This past November, voters in Michigan, Missouri, and Utah approved ballot measures to legalize marijuana for recreational and medical use. To date, the medical use of marijuana has been legalized in 33 states and the District of Columbia, while recreational use is permitted in 10 states. Nevertheless, the possession, sale, or use of marijuana remains illegal under federal law, which classifies the drug as "Schedule 1," on a par with heroin. This difference in federal and state law has created a gray area for businesses in this market and banks that would otherwise serve them.

Despite the uncertainty the industry is not insignificant. In 2018 the legal marijuana industry grew to $10.4 billion, and it is expected to grow to $146.5 billion by 2025. As of last year, however, only 30 percent of marijuana businesses had bank accounts and less than 500 banks or credit unions had active operating accounts for such businesses.

This issue has prompted the House Committee on Financial Services to host a hearing on February 13 to discuss some of the problems banks face when trying to serve legal marijuana businesses.

Given the continuing growth of the legal marijuana industry, the tension between states and the federal government over legality, and reticence on the part of lawmakers and regulators to expand the access of legal marijuana businesses to banking services, it is important to understand both the policies that created the issue in the first place and the policy proposals that may remedy it.

The Broader Regulatory Framework

Besides the obvious implications of breaking federal law, the broader regulatory environment makes it difficult for banks to offer even basic banking services to legal marijuana businesses.

Since handling the proceeds of any marijuana transactions can be considered money laundering, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) requires banks to file Suspicious Activity Reports

(SARs) for each transaction. Filed in suspected cases of money laundering, terrorist financing, or fraud, the SARs are used to help law enforcement identify criminal activity and catch those involved in such crimes. The SARs and other anti-money laundering rules cost banks an astonishing $8 billion annually. More about anti-money laundering policies can be found here.

Without access to banking services, marijuana businesses are left with only two real choices.

The first and more common choice is to conduct their dealings in physical, untraceable cash. These dealings include the transactions themselves, but also the storage of their earnings, the payment of employees, and even the payment of taxes. Besides the annoyance, the cash-only system increases the likelihood that funds will be used for illegal purposes – ironic considering the whole purpose of the aforementioned SARs is to rout illegal financing and activities.

Alternately, marijuana businesses turn to private equity or direct lenders. These firms, however, often charge high interest and operate nonstandard lending arrangements. Given the hesitation of U.S. banks to enter the industry, Canadian banks have filled the void. Since marijuana is legal at the federal level in Canada, it's easier and less controversial for Canadian banks to participate in marijuana banking in the United States.

The fact that legal businesses are essentially forced to turn to physical cash or foreign banks and financiers to do their banking demonstrates there is a need for banking services that American service providers are not currently meeting.

Legislative Difficulties in Legal Marijuana Banking

In 2014, FinCEN issued guidance that allowed banks to open accounts for marijuana businesses without running into issues with federal laws and regulations. This however ran into difficulties in early 2018 when then-Attorney General Jeff Sessions revoked an Obama-era Department of Justice guidance that enabled state marijuana laws, causing concern for many in the industry that a similar response was likely for marijuana banking guidance. Sessions never formally revoked the guidance, however.

During the 115th Congress, two main pieces of legislation were introduced that dealt with the issues facing marijuana businesses and banks.

In 2017, Congressman Ed Perlmutter introduced the SAFE Act, which would prohibit federal regulators from bringing enforcement actions against banks that service marijuana businesses in states where the drug is legal. The Independent Community Bankers Association , the main trade association for community-sized banks in the United States, expressed support for the legislation, as did a group of bipartisan state attorneys general. Similarly, in 2018 Senators Cory Gardner and Elizabeth Warren introduced the STATES Act, which would protect states from federal intervention in state marijuana legality. While not banking-specific and broader in scope, the proposed bill would accomplish much of the same as the SAFE Act. To the surprise of some in the industry, President Donald Trump announced that he would "probably" support the bill. Neither piece of legislation was ultimately successful.

The most consequential recent legislative movement in this arena actually had very little to do with marijuana banking itself. In December of last year, Congress passed and President Trump signed the Agricultural Improvement Act of 2018, more commonly known as the Farm Bill. Under the stewardship of Senate Majority Leader Mitch McConnell, the bill included a provision that made hemp legal, defining it as a cannabis with far lower tetrahydrocannabinol (THC), the main psychoactive ingredient found in marijuana, than that used for recreational or medical purposes. This gave industrial hemp farms the right to grow, sell, and transport the plant without fear of federal prosecution. With newfound legalization, banks who formerly refused to serve these businesses have moved into the market. Beyond that, many in the industry have viewed this development as an indication that there may be further congressional appetite to address legal marijuana banking more broadly.

Conclusion

Facing uncertain legality, the growing legal marijuana-related industry is at a disadvantage in terms of access to financial services, which face an onerous regulatory burden. An upcoming hearing by the House Financial Services Committee indicates that the issue is on the mind of many in Congress. Legislation that gives legal businesses that are otherwise susceptible to money laundering or other fraud access to financial services is sound policy. Any proposals that emerge from the committee's discussion may very well see progress in the 116th Congress.