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COLORADO

Colorado's Marijuana Financial System Unlikely to Solve Pot Banking Dilemma



BY ZANE GILMER

In January 2014, Colorado became the first state in the Union to permit the sale of recreational marijuana. On May 7, 2014, Colorado made history again by passing the Marijuana Financial Services Cooperatives Act (the "Marijuana Co-op Act"), which would create the world's first marijuana-related financial system.¹ Governor John Hickenlooper reportedly is expected to sign the bill into law.² The Marijuana Co-op Act permits the creation of financial services coopera-

¹ H.B. 14-1398, 69th Gen. Assem., 2nd Reg. Sess. (CO. 2014), available at http://www.leg.state.co.us/Clics/CLICS2014A/csl.nsf/fsbillcont3/06F7F4159729909387257CCA0082B929?Open&file=1398_01.pdf.

² David Migoya & Anthony Cotton, *Gov. John Hickenlooper Likely to Approve Marijuana Co-op Bill*, May 9, 2014, The Denver Post, available at http://www.denverpost.com/marijuana/ci_25726309/gov-john-hickenlooper-likely-approve-marijuana-co-op.

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tives (referred to as "cannabis credit co-ops") to provide financial services to the marijuana industry.³ The Marijuana Co-op Act was introduced, and ultimately passed, in response to the growing "cash only" problem facing the marijuana industry.

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As the new marijuana industry took off, unforeseen complications emerged. Because the possession, manufacture and distribution of marijuana remain illegal under federal law, traditional financial institutions are largely unwilling to offer banking services to the marijuana industry out of fear of running afoul of federal regulations, including their anti-money laundering obligations pursuant to the Bank Secrecy Act.⁴ The marijuana industry's lack of banking access creates a multitude of problems, not-the-least of which is the public safety concerns created by the "cash only" nature of the marijuana industry. In March 2014 alone the Colorado recreational marijuana industry's sales nearly topped \$19 million.⁵ With that amount of cash and nowhere to store it, pot shops are prime targets for robberies.

The federal government took notice of the marijuana banking dilemma and, in February 2014, the Department of Treasury's Financial Crimes Enforcement Net-

³ *Id.*

⁴ 21 U.S.C. § 841, *et seq.* (Controlled Substances Act); *see also* 31 U.S.C. § 5311, *et seq.* (Bank Secrecy Act); 18 U.S.C. §§ 1956 and 1957 (federal anti-money laundering statutes).

⁵ The Associated Press, *Colorado Pot Taxes Boomed in March*, The Denver Post, May 8, 2014, available at http://www.denverpost.com/marijuana/ci_25725179/colorado-pot-taxes-boomed-march.

work (“FinCEN”) and Department of Justice (“DOJ”) issued separate guidance with the express purpose to “enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses.”⁶ That guidance, however, failed to provide banks with the necessary assurances that if they provided banking services to marijuana-related businesses, they (the banks) would not be subject to regulatory, civil or criminal prosecution or other action.⁷ The guidance, therefore, failed to solve the “cash only” problem.

In response to the financial industry balking at FinCEN’s guidance, the Colorado legislature passed the Marijuana Co-Act; however, it too is unlikely to solve the marijuana-industry’s cash only problems.

Overview of the Marijuana Co-op Act

The Marijuana Co-op Act permits the creation of cannabis credit co-ops comprised of state-licensed marijuana businesses, industrial hemp businesses and other entities as long those entities can prove that they are unable to obtain comparable banking services from traditional financial institutions.⁸ To operate, the cooperatives must obtain licensing from the State of Colorado and, most importantly, the Federal Reserve System Board of Governors.⁹ Once approved, the cannabis credit co-ops are permitted to operate much like a traditional financial institution in that they can receive member deposits, make loans to members or other cannabis co-ops, make certain investments and deposit funds in state and national financial institutions insured by the federal government (if that institution voluntarily accepts the marijuana-related deposits).¹⁰ The cannabis credit co-ops, moreover, are subject to most of the same regulatory and legal obligations as their more traditional counterparts. In fact, as discussed below, given the nature of the cooperatives’ business, they are actually subject to greater regulation and scrutiny.

⁶ FinCEN Guidance, *BSA Expectations Regarding Marijuana-Related Businesses*, Feb. 14, 2014, available at http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf; James M. Cole, *Guidance Regarding Marijuana Related Financial Crimes*, U.S. Department of Justice, Feb. 14, 2014 (“DOJ Guidance”), available at <http://www.justice.gov/usao/co/news/2014/feb/DAG%20Memo%20-%20Guidance%20Regarding%20Marijuana%20Related%20Financial%20Crimes%202%2014%2014.pdf>.

⁷ See Zane Gilmer, *Financial Industry Should Remain Cautious Despite Federal Marijuana Banking Guidance*, Bloomberg BNA’s *Banking Report*, Feb. 24, 2014, available at http://www.perkinscoie.com/files/upload/02_27_2014_Gilmer_BNA.PDF; The Colorado Bankers Association, *CBA Statement Regarding DOJ and Treasury Guidance on Marijuana and Banking*, available at <http://www.coloradobankers.org/displaycommon.cfm?an=1&subarticlenbr=60>.

⁸ H.B. 14-1398.

⁹ *Id.*

¹⁰ *Id.*

Cannabis Credit Co-ops Unlikely to Solve Marijuana Industry’s Banking Problem

The biggest and perhaps most glaring issue with the Marijuana Co-op Act is that it creates not only a novel financial system, but also one comprised of businesses openly violating federal drug laws. As one can imagine, this creates a few complications. For instance, the Marijuana Co-op Act expressly requires the cannabis credit co-ops to receive approval from the Federal Reserve System Board of Governors before they are permitted to operate.¹¹ Whether the Federal Reserve approves the cannabis co-ops remains unclear and unlikely given the banking industry’s previous reluctance to associate with marijuana-related businesses. That said, it is not beyond the realm of possibility given FinCEN’s recent guidance on banking marijuana funds; however, without Federal Reserve approval the Marijuana Co-op Act is essentially moot as the cannabis credit co-ops cannot operate without it.

In addition — setting aside the issue of whether the Federal Reserve would (or could) approve the cannabis credit co-ops — the cost and administrative burdens associated with creating and operating a cannabis credit co-op will likely prevent their creation. The banking and financial system and its associated regulations are complex. Indeed, the financial industry is one of the most heavily regulated industries in the world. As a consequence, organizing a financial institution, obtaining proper regulatory authority and operating in compliance with complex and ever changing regulations is expensive and time-consuming. Additionally, compliance with the certain federal regulations creates a host of issues unique to financial institutions dealing with marijuana funds.

The Marijuana Co-op Act, for instance, requires cannabis credit co-ops to comply with federal law applicable to other financial institutions, such as the Bank Secrecy Act, by, among other things, filing Suspicious Activity Reports (“SARs”) when necessary.¹² According to FinCEN’s guidance, “A financial institution is required to file a SAR if, consistent with FinCEN regulations, the financial institution knows, suspects, or has reason to suspect that a transaction conducted or attempted by, at, or through the financial institution: (i) involves funds derived from illegal activity or is an attempt to disguise funds derived from illegal activity[.]”¹³ The guidance goes on to state that, “Therefore, a financial institution is required to file a SAR on activity involving a marijuana-related business (including those duly licensed under state law), in accordance with this guidance and FinCEN’s suspicious activity reporting requirements and related thresh-

¹¹ *Id.*

¹² *Id.*

¹³ FinCEN Guidance, p. 3.

olds.”¹⁴ Because the possession, manufacture and distribution of marijuana is still illegal under federal law, virtually every transaction a cannabis credit co-op engaged in would require a marijuana-related SAR.¹⁵

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Additionally, cannabis credit co-ops would be required to develop and implement extensive due diligence and customer identification requirements to avoid running afoul of state and federal regulations.¹⁶ The Marijuana Co-op Act, for instance, requires cannabis credit co-ops to conduct due diligence of its members to ensure compliance with DOJ’s eight marijuana-related enforcement priorities, which include preventing: (1) the distribution of marijuana to minors; (2) revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels; (3) the diversion of marijuana from states where it is legal under state law to other states where it is not legal; (4) state-authorized marijuana activity from being used as a cover or pretext for trafficking other illegal drugs or illegal activity; (5) violence and the use of firearms in the cultivation and distribution of marijuana; (6) drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use; (7) the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and (8) marijuana possession or use on federal property.¹⁷

To avoid violating one of DOJ’s eight priorities, FinCEN’s guidance requires a financial institution dealing in marijuana funds to create a due diligence program that includes, at a minimum: (1) verifying with state authorities whether the marijuana-related business is licensed and registered; (2) reviewing (and presumably scrutinizing) the state application and supporting documentation submitted by the marijuana-related business to the state authorities in support of its marijuana application; (3) requesting from the state authorities information related to the marijuana-related business and individuals involved with it; (4) developing an understanding of the marijuana-related business’s “normal and expected activity,” including the products it sells and types of customers it serves (i.e., recreational vs. medical); (5) ongoing monitoring of adverse public information concerning the marijuana-related business and related parties; (6) ongoing monitoring for any suspicious activity, including “red flags” described in the guidance; and (7) updating the due diligence information on a periodic basis and commensurate with the

¹⁴ *Id.*

¹⁵ *Id.* at pp. 3-7.

¹⁶ H.B. 14-1398.

¹⁷ H.B. 14-1398; DOJ Guidance, p. 1.

risk.¹⁸ The resources and expertise required to develop and implement this type of comprehensive due diligence program will make it difficult, if not impossible, to operate a compliant cannabis credit co-op. Indeed, an adequate due diligence program would require thoroughly vetting each marijuana-related member at the outset of the relationship and continued monitoring and updating to ensure continued compliance.

The risks associated with cannabis credit co-ops are not limited, however, to economic and administrative burdens. Indeed, the deposits in cannabis credit co-ops are not required to be (and likely cannot be) insured, and the Marijuana Co-op Act expressly states that such deposits will not be backed by the state or federal government. Thus, members who deposit their funds into a cannabis credit co-op risk losing them to robbery, destruction or other circumstances. Additionally, proceeds of marijuana sales are subject to federal forfeiture laws because they are proceeds of illegal activity.¹⁹ Creating a collective depository where such proceeds are stored increases the risk of federal seizure. The cannabis credit co-op operators, moreover, could face criminal liability, including money laundering or aiding and abetting charges.²⁰

Federal Action Is Necessary to Solve Pot Banking Issues

Because the possession, manufacture and distribution of marijuana remains illegal under federal law, even if the Federal Reserve approves the cannabis credit co-ops, many compliance issues remain. Those issues can only be resolved with additional federal action. That is, either the Controlled Substances Act must be amended to decriminalize the possession, manufacture and distribution of marijuana at the federal level (an unlikely move in the near term), or Congress must pass legislation permitting the financial industry to offer banking services to the marijuana industry without fear of civil or criminal retribution. The proposed Marijuana Business Access to Banking Act of 2013, which would allow banks to interact with the marijuana indus-

¹⁸ FinCEN Guidance, pp. 2-3.

¹⁹ See e.g. 21 U.S.C. § 853 (criminal forfeiture statute related to controlled substance violations); 18 U.S.C. § 981, *et seq.* (civil forfeiture statute related to money laundering).

²⁰ 18 U.S.C. § 2 (federal aiding and abetting statute); 18 U.S.C. §§ 1956 and 1957 (federal anti-money laundering statutes).

Note to Readers

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try, is currently pending in committee.²¹ That legislation, however, has struggled to gain widespread support from legislatures outside of Colorado and Washington. If the Marijuana Co-op Act is successful at

²¹ Marijuana Businesses Access to Banking Act of 2013, H.R. 2652, 112th Cong. (2013), available at <https://www.govtrack.us/congress/bills/113/hr2652/text>.

anything, it will likely be at sparking further debate about the need for the federal government to act to solve the marijuana banking problem. Without additional federal action, however, the traditional financial industry will likely (and wisely) continue to avoid the marijuana industry, and the marijuana industry's banking woes will continue.