“NORTH AMERICAN (CANNABIS) SALES ARE PROJECTED TO TOP $20.2 BILLION BY 2021, ASSUMING A COMPOUND ANNUAL GROWTH RATE OF 25%...TO PUT THIS IN PERSPECTIVE, THE INDUSTRY GROWTH IS LARGER AND FASTER THAN EVEN THE DOT-COM ERA.”

— Source: Arcview Market Research; Marijuana Sales Totaled $6.7 Billion in 2016; Forbes.com
Dear Fellow Californians:

California is entering a new era with the legalization of adult recreational cannabis.

Medical cannabis has been permitted in California for more than two decades. Now, the decriminalizing of adult recreational cannabis, which voters overwhelmingly approved in November 2016, will vastly expand the scale of the industry. It is estimated that legal cannabis will generate more than $7 billion in annual sales in its first few years of operation, beginning on January 1, 2018.

California regulatory agencies, law enforcement, and entrepreneurs have been working diligently to prepare for a smooth transition to legalization.

But the nascent industry faces an enormous challenge. The production, distribution, sale, and possession of cannabis remain illegal under federal law. Cannabis and many of its byproducts continue to be listed as Schedule I controlled substances, akin to heroin.

The clash between state and federal law threatens to cripple legal California cannabis businesses before they even get up and running. One of the main threats to legalization is that banks generally will not open accounts for cannabis businesses out of fear they will be penalized under federal law.

Lack of access to banking services that are taken for granted by other legal businesses—opening accounts, writing checks, accepting credit cards, transferring money—forces cannabis businesses to deal in large amounts of cash, which makes them targets for assaults and puts the general public in danger. Security and procedural concerns about handling massive amounts of cash also create a nightmare for state and local government revenue-collecting agencies. In addition, the inability of cannabis operations to get banking services means that many of them may remain in the underground economy and not become transparent, regulated, tax-paying businesses, as California voters intended.

Faced with these concerns, late last year I directed the staff of the State Treasurer’s Office to carry out research and develop recommendations on strategies to address the cannabis banking conundrum. As the state’s banker, I felt an obligation to fulfill the wishes of the voters when they passed Proposition 64 in November 2016.
Since then, I created a panel of 18 stakeholders—the Cannabis Banking Working Group—made up of representatives from the cannabis industry, financial institutions, and government tax collection, law enforcement, and regulatory agencies. The Working Group held six public meetings around the state and heard from nearly 50 expert panelists. Working Group members and their designated representative took time from busy schedules and worked diligently to consider ways to deal with the cannabis banking problem. The people of California owe them a great debt of thanks.

Based on the Working Group’s findings, my office believes the best way to approach the cannabis banking problem is to think in terms of a series of steps, each of which involves greater access to banking services. The starting point is the current situation, in which the cannabis industry operates predominantly in cash, with only sporadic banking access. The end point is federal legalization of cannabis or, if that is not achievable, legislation shielding financial institutions that serve the cannabis industry. To progress along this continuum, we recommend the following actions: (1) the implementation of safer, more effective, and scalable ways to handle the payment of taxes and fees in cash that minimize the risks to stakeholders; (2) the State of California and local governments should develop a data portal of compliance and regulatory data and make it available to financial institutions that bank cannabis businesses; (3) a feasibility study of a public bank or other state-backed financial institution that provides banking services to the cannabis industry should be conducted; and (4) a multistate consortium of state government representatives and other stakeholders should be established to pursue changes to federal law to remove the barriers to cannabis banking.

In the end, it became apparent that a definitive solution to the cannabis banking quandary will remain elusive until the federal government removes cannabis from its official list of dangerous drugs or Congress approves safe harbor legislation protecting financial institutions that serve cannabis businesses from federal penalties.

The Working Group also heard from numerous vendors selling products and services that claim to provide cannabis businesses banking access. It is important to remember that contrary to what some solution providers have represented, there is no durable, failsafe solution to the banking problem until federal law is changed, and neither the Working Group nor the State Treasurer’s Office endorses any particular product or service. Vendors should be selected with care, and the Appendix to this report suggests questions to ask vendors before hiring them.

California has exercised national leadership in areas ranging from enhancing civil rights to protecting the environment. The arrival of legal adult recreational cannabis offers another opportunity for our state to set an example. I am convinced we can find ways to expand cannabis industry banking access and make Proposition 64 a success.

Sincerely,

JOHN CHIANG
California State Treasurer
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EXECUTIVE SUMMARY

Proposition 64 approving production, distribution, sale, and possession of adult recreational cannabis—passed by California voters in November 2016—ushers in a new era in the state. When the measure takes effect January 1, 2018, adult recreational use of cannabis will join medical use as a legal practice in California. But a shadow hangs over Proposition 64. Cannabis possession and sale remain federal crimes, a conflict that threatens to frustrate the will of California voters.

One of the consequences of the clash between state and federal law is that California's legal cannabis businesses are largely locked out of the banking system. Because cannabis is still illegal under federal law, an overwhelming majority of financial institutions do not serve the cannabis industry. As a result, cannabis businesses are generally unable to write checks, make and receive electronic payments, or accept credit and debit cards. The cannabis industry operates chiefly in cash, just as it did when it was in the illegal market. The lack of access to banking services is not just a California problem—it is a major concern in each of the 29 states and the District of Columbia that have broadly legalized medical use, or both medical and adult recreational use, of cannabis.

The cannabis industry’s inability to get basic banking services is an urgent public policy issue requiring concerted action by state and local governments, the cannabis industry, and financial institutions.

Ensuring cannabis industry access to banking services is in the public interest for three reasons:

• Large amounts of cash make cannabis businesses, their employees, and their customers targets of violent crime.

• State and local government agencies that collect tax and fee payments in cash from the cannabis industry incur added expenses, demands on staff time, and risks to employee safety.

• Normal access to banking services is an essential part of taking the cannabis industry out of the shadows and establishing it as a transparent, regulated, tax-paying part of the California economy. Banking relationships can help law enforcement officials and regulators distinguish legal cannabis businesses from illegal market operators.

To address the problem of cannabis industry access to banking services, State Treasurer John Chiang convened the Cannabis Banking Working Group (CBWG), composed of representatives of state and local government, and the cannabis and financial services industries. The group held six public meetings throughout California between December 2016 and August 2017, and heard from nearly 50 panelists.

Based on the facts gathered by the CBWG, the State Treasurer’s Office believes the best way to approach the problem of cannabis and banking is to think in terms of a series of steps, each of which involves greater access to banking services. The starting point is the current situation, in which the cannabis industry operates predominantly in cash, with only sporadic banking access. The end point is federal legalization of cannabis or, if that is not achievable, legislation shielding financial institutions that serve the cannabis industry. Federal reform would

57% OF CALIFORNIA VOTERS APPROVED PROP. 64

$1B ESTIMATED IN NEW TAX REVENUE*

$7.6B IN CANNABIS SALES PROJECTED BY 2020**

*Source: Legislative Analyst Office

**Source: Arcview Market Research, November 9, 2016; New California Marijuana Market Projection
let cannabis businesses open accounts, make deposits, and handle payments normally, like other regulated businesses.

Strategies short of federal reform are not solutions. Rather, they are stopgap measures to protect public safety, improve revenue collection, and help establish a regulated cannabis industry until federal law is changed.

This report presents the CBWG’s findings on opening the banking system to cannabis businesses and moving the industry away from cash. The report considers the pros and cons of different strategies and the State Treasurer’s Office recommends action in four key areas. Some of these recommendations are based on lessons learned regarding what has or has not worked in other states.

**(1) Cash handling for the collection of taxes and fees**

For state and local government agencies, collecting taxes and fees in cash is a risky and expensive proposition. The CBWG examined a number of methods for transporting, processing, and receiving taxes and fees paid in cash. These methods were evaluated based on whether they would be safe for taxpayers and agency staff, efficient, and cost-effective. Specifically, the CBWG considered a variety of cash collection and payment alternatives, including smart safes and kiosks, armored couriers, money services businesses, and payment services.

**STATE TREASURER’S OFFICE RECOMMENDATION:****

The state taxing agencies should work with the State Treasurer’s Office and financial institutions to contract with an armored courier service that will collect state tax and licensing payments made in cash from businesses in California, including cannabis businesses, that do not have deposit accounts. On behalf of the state, the armored couriers would pick up cash from the businesses and transport those receipts to a secure counting and verifying facility before taking the cash payments to either a Federal Reserve facility or a financial institution willing to accept the cash as deposits to state accounts. Armored courier services would eliminate the need to directly handle large sums of cash at branch offices or open deposit accounts at financial institutions while easing know-your-customer requirements because the state would be the customer. Such an arrangement would address a number of barriers to the collection of tax and fee payments, and result in increased safety, would not require banks to engage in activities that expose them to greater risk than they are willing to take, and increase taxpayer compliance. The Treasurer’s Office and state agencies should identify the appropriate contractors for this service and specify which parties would be responsible for paying. State agencies should offer this option to local government units through partnerships or similar arrangements, which would permit collection of local taxes and licensing fees, provided that statutory authority exists and a method is established for local agencies to pay the costs of the service.

**(2) Expanding cannabis industry access to banking services under current law**

Although cannabis remains illegal under federal law, federal enforcement policy has opened a narrow and fragile path for cannabis banking. In particular, the U.S. Justice Department’s Cole Memorandum and the Treasury Department’s FinCEN Guidance offer guidelines on how financial institutions may serve cannabis businesses. These guidelines set strict standards for complying with anti-money laundering and anti-terrorism know-your-customer rules, such as ensuring cannabis businesses are not affiliated with criminal cartels.

However, these guidelines do not offer a safe harbor from federal law. And most financial institutions view the requirements as too onerous and uncertain to make cannabis banking worthwhile. Yet, based on these guidelines, a handful of financial institutions are serving the cannabis industry in other states and it is probable some will do so in California as well. The CBWG considered ways to expand this small bridgehead into the banking system.

**STATE TREASURER’S OFFICE RECOMMENDATION:****

The State of California and local governments should create an online portal aggregating data on cannabis businesses from local government units and all 11 state agencies with cannabis regulatory or data-collection responsibilities. The portal should be designed with financial institution compliance needs in mind and provide material to help institutions fulfill their know-your-customer responsibilities. The data should include licensing and regulatory information, data on key personnel, product lists, sources of supply, financial records including major transactions, ongoing regulatory activity including citations for violations, adverse comments, and evidence of suspicious or illegal activities, provided such material is not restricted by disclosure rules or other agreements.

**(3) A state-backed financial institution**

One possible strategy for expanding cannabis access to banking services is to create a publicly owned or supported financial institution in California to serve the industry. Such an institution might have a broad mission to expand banking for underserved groups, including the cannabis industry, or it might be a narrowly focused cannabis financial institution primarily serving cannabis producers, distributors, and retailers. Alternatively, the state could back a privately owned bankers’ bank or corporate credit union, which would provide services to financial institutions that serve the cannabis industry.

The obstacles to creating a public financial institution are formidable, including the difficulty of getting deposit insurance,
unknown start-up costs, investment likely to measure in the billions of dollars, and the probability of losses for several years or more that taxpayers would have to cover. In addition, a public cannabis institution might have trouble obtaining federal regulatory approval and access to Federal Reserve money transfer systems.

STATE TREASURER’S OFFICE RECOMMENDATION:
A feasibility study should be conducted to determine whether creation of a public cannabis financial institution or a bankers’ bank or corporate credit union is advisable. The study should consider costs, benefits, risks, and regulatory issues, including capitalization, deposit insurance, and access to interbank funds transfer systems. It should also examine various ownership structures, including appropriate mixes of public and private capital. The feasibility study should include a legal analysis addressing the legality and associated legal risks of creating a public cannabis financial institution, including, but not limited to, whether such an institution can be created without violating federal law, the extent to which it would remain subject to federal oversight and regulation, and whether tax revenues deposited in it could be at risk of seizure by the federal government.

(4) Full Access to Banking Services: The Federal Solution
The final step in providing banking services to the cannabis industry is removing federal legal and regulatory roadblocks, the end game which would allow cannabis to be treated like other cash-intensive regulated industries, such as casinos and pawnshops. Removal of federal restrictions requires congressional legislation and changes in executive branch policy. However, the Justice Department under U.S. Attorney General Jeff Sessions opposes state marijuana legalization and supports strict enforcement of federal drug laws.

Congress currently bars the Justice Department from spending money to prosecute those involved with state medical marijuana programs. Legislation to tear down obstacles to cannabis banking follows three tracks. One approach would provide a legal safe harbor to financial institutions by prohibiting federal prosecutors or regulators from penalizing them for serving cannabis customers that comply with state law. A second approach would legalize cannabis by taking it off the list of Schedule I controlled substances. A third would prohibit federal officials from prosecuting cannabis consumers or businesses in states that have approved medical or adult recreational use.

STATE TREASURER’S OFFICE RECOMMENDATION:
A multistate consortium should be created which includes representatives of cannabis-legal states, local governments, the cannabis and financial services industries, and law enforcement. The consortium would have a three-part mission: (1) education and outreach to ensure that opinion leaders and the public understand state cannabis policies and the problem of banking access; (2) maintaining a central repository for information on state cannabis laws, including lessons learned; and (3) congressional and executive-branch policy advocacy, which should be coordinated to make sure that cannabis-legal states speak with one voice.

Opening the banking system is an essential part of California’s bold effort to build a safe, legal, and responsible cannabis industry in the state. Even the best regulatory program won’t succeed unless cannabis businesses become law-abiding, transparent tax-paying members of their communities. But it is hard for cannabis businesses to make that commitment if they can’t write checks, take credit cards, and move money like any other business. It is a challenge to ensure cannabis businesses obey the law if they mainly use cash. In this respect, banking access is integral and critical to successful implementation of Proposition 64.

“AS A GROWER I WOULD HAVE HAD TO LIE ABOUT WHAT I DID FOR A LIVING — AND THAT WAS SOMETHING I WAS UNWILLING TO DO.”
— Hezekiah Allen, California Growers Association
On November 8, 2016, California voters passed Proposition 64 legalizing production, distribution, sale, and possession of cannabis by adults. The measure, approved by a 57–43 percent margin, was followed by enactment of a state implementation law, the Medicinal and Adult Use Cannabis Regulation and Safety Act (MAUCRSA). These laws, which take full effect on January 1, 2018, usher in a new era in California.

Medical cannabis has been legal in California since 1996, and a network of producers, distributors, and dispensaries has developed to meet demand. With adult recreational use, the cannabis industry will mushroom. Cannabis will record nearly $7 billion in annual sales when adult recreational use takes effect, and nearly three times that figure within five years, according to conservative estimates. A ripple effect will magnify the economic impact as jobs are created in businesses that serve the cannabis industry and its employees—everything from law firms and garden supply stores to restaurants and cafes.

The rapid growth of California’s legal cannabis industry will set in motion far-reaching judicial, fiscal, and cultural changes. Cannabis producers, distributors, retailers, and consumers will no longer be lawbreakers in the eyes of the state, removing the threat of jail or other criminal penalties. California’s criminal justice system, including courts, jails, and prisons, will no longer be burdened by cannabis offenders. State and local governments will benefit from a new source of revenue projected to exceed $1 billion annually, according to the Legislative Analyst’s Office. This revenue can be used for social and medical programs, scientific research, education, and more.

But a shadow hangs over Proposition 64. The federal government considers cannabis a dangerous drug, similar to heroin. Its production, distribution, sale, and possession remain federal crimes. The federal government has consistently rejected the idea that cannabis, known as marijuana under federal law, has legitimate medical uses. California’s legalization of adult recreational use is aggravating this conflict, a clash that threatens to frustrate the will of California voters.

Because cannabis is illegal under federal law, the industry faces a fundamental problem—an overwhelming majority of financial institutions that take deposits and offer checking accounts, including banks, thrifts, and credit unions, do not serve cannabis businesses, even though the U.S. Justice and Treasury Departments hold that cannabis banking is permissible if a strict set of guidelines is followed. As a result, cannabis businesses are generally unable to write checks, make and receive electronic payments, or accept credit and debit cards. In the cannabis world, cash is king. The cannabis industry’s lack of access to banking services is one of the biggest threats to the success of Proposition 64.

This is not just a California problem. It’s a major concern in each of the 29 states and the District of Columbia that have broadly legalized medical cannabis, or both medical and adult recreational cannabis. In these jurisdictions, the cannabis industry continues to operate extensively on a cash basis.

The industry’s inability to get basic banking services is an urgent public policy issue requiring concerted action by state and local government, the cannabis industry, and financial institutions.

### Ensuring cannabis industry access to banking services is in the public interest for three reasons:

- **Large amounts of cash make cannabis businesses and their employees targets of violent crime.**
- **State and local government agencies that take tax and fee payments in cash from the cannabis industry incur added expenses, demands on staff time, and, above all, risks to employee safety.**
- **Normal access to banking services is an essential part of taking the cannabis industry out of the illegal market and establishing it as a transparent, regulated, tax-paying part of the California economy.**

To address the problem of cannabis industry access to banking services, State Treasurer John Chiang convened the Cannabis Banking Working Group (CBWG) composed of representatives of state and local government, and the cannabis and financial services industries. The group held six public meetings throughout California between December 2016 and August 2017, and heard from nearly 50 expert panelists. The CBWG heard compelling real-life stories about the troubles caused by the cannabis industry’s lack of access to banking services and explored a range of approaches, including best practices for handling cash, ways to obtain banking services under current law, and changing federal law to open the financial system to cannabis businesses.

This report outlines the problem of cannabis industry access to banking services and presents the CBWG’s findings and the State Treasurer’s Office recommendations in four key areas: (1) cash handling for the collection of taxes and fees; (2) expanding cannabis industry access to banking services under current law; (3) the feasibility of creating a public or private financial institution to serve cannabis businesses; and (4) developing a strategy to change federal law and remove legal obstacles to cannabis banking. The report considers the pros and cons of potential strategies in each area and recommends specific courses of action. Some of these recommendations
are based on lessons learned regarding what has or has not worked in other states.

The State Treasurer’s Office believes it is only a matter of time until cannabis businesses have normal access to banking services. But that is not an excuse for inaction. If law-abiding cannabis businesses are not treated as legitimate enterprises, many of them will not be motivated to operate legally and will remain in the illegal market instead. That would deprive state and local government of tax and license revenues. And it would expose cannabis businesses and employees to increased risk of violent crime.

The federal government has legitimate concerns about criminal activity that has sometimes been associated with cannabis, including money laundering and relations with criminal cartels. The irony is that, by keeping cannabis businesses largely locked out of the banking system and forcing them to rely on cash, the federal government raises the risk of crime. Without banking services, cannabis businesses are less able to obey the law, pay taxes, and follow the regulations California is putting in place.

The cannabis industry is poised for major expansion when legal adult recreational use arrives. But the question is, what kind of industry will it be? Will cannabis be a law-abiding, transparent, well-regulated industry, as California voters intended? Or will it keep one foot in the underground economy? The answers depend in no small measure on whether the banking system opens up to cannabis businesses. California must take the initiative to help ensure that happens.

KEY AREAS OF THIS REPORT:

1. Cash Handling and Collection of Taxes & Fees
2. Expanding Cannabis Industry Access to Banking Services Under Existing Law
3. Creating a State-Backed Financial Institution to Serve Cannabis Businesses
4. Developing a Strategy to Change Federal Law and Remove Legal Obstacles to Cannabis Banking
Under federal law, cannabis products are classified as illegal Schedule I controlled substances. That classification is the primary barrier keeping the cannabis industry out of the banking system. The issue is federal anti-money laundering and anti-terrorism laws, most notably the Bank Secrecy Act and the USA PATRIOT Act, which make it illegal for financial institutions to handle funds stemming from criminal activity, including violations of federal drug laws. In addition, the Racketeer Influenced and Corrupt Organizations (RICO) Act provides that all property bought with proceeds of illegal activity is subject to forfeiture, regardless of state law. Thus, RICO restricts cannabis lending because, if the federal government seizes cannabis business property, the lender would lose collateral protecting against losses.

As states across the country considered medical and adult recreational legalization measures, the Obama administration recognized that the inability of state-legal cannabis businesses to get banking services caused a range of problems, including robberies and tax evasion. The U.S. Justice and Treasury Departments responded in 2013 and 2014 by issuing guidelines on how financial institutions could permissibly serve cannabis customers. John Vardaman, a former Justice Department official, now an executive with Hypur, a compliance consulting firm, in remarks to the CBWG called these guidelines a “roadmap” for cannabis banking.

The two most important federal cannabis banking guidelines are the Justice Department’s Cole Memorandum, issued in 2013, and FinCEN Guidance, a set of instructions issued by the Treasury Department’s Financial Crimes Enforcement Network in 2014.

The Cole Memorandum lists eight cannabis enforcement priorities for federal prosecutors, including keeping cannabis out of the hands of minors, preventing it from being sent to states where cannabis is illegal, and ensuring cannabis proceeds don’t end up in the hands of criminal organizations. The memorandum concludes that, unless these priority violations are involved, prosecution of cannabis businesses or financial institutions serving them may not be appropriate.

The FinCEN Guidance provides specific directions on how financial institutions should manage relationships with cannabis businesses. In particular, it spells out the steps a financial institution should take to make sure that it follows the anti-money laundering rules contained in the Bank Secrecy Act and the USA PATRIOT Act.

Foremost among these is the requirement to know your customer, that is, to be certain that a cannabis business customer is complying with state laws and regulations, and is not engaging in any of the activities prohibited under the Cole Memorandum. In addition, the FinCEN Guidance establishes specific monitoring and reporting requirements that financial institutions must follow for cannabis customers, including completion of special “suspicious activity reports” on these businesses.

While these guidelines have opened a narrow and fragile path to cannabis banking, few financial institutions have chosen to follow it. University of Alabama law professor Julie Hill told the CBWG the main reason is that these federal guidelines don’t have the force of law and can be withdrawn at any time. Also, the
guidelines don’t guarantee that the U.S. government won’t take action against financial institutions that follow the rules. Instead, the guidelines hedge their bets, merely stating enforcement action may not be warranted.

In addition, nearly all banks, thrifts, and credit unions require federal deposit insurance to protect depositors. Moreover, these institutions use Federal Reserve systems for transferring funds, including check clearing, Fedwire, and automated clearing house (ACH). This puts institutions under the supervision of federal financial regulatory agencies. Even banks, credit unions, and thrifts that operate under state rather than national charters are generally supervised by the Federal Reserve, the National Credit Union Administration, or the Federal Deposit Insurance Corp. These regulatory agencies have the authority to shut financial institutions down.

In states across the country, a number of financial institutions that accept cannabis business customers have passed regulatory exams, according to some financial institution executives. Apparently, some federal regulators accept cannabis banking under some circumstances. Nonetheless, the main federal regulatory agencies have not issued public statements explicitly defining their policies on cannabis banking, and uncertainty about their stance is widespread. Vardaman called federal regulators “the X factor” in cannabis banking.

Finally, Attorney General Sessions staunchly opposes state cannabis legalization and has asked Congress to lift restrictions against prosecuting businesses and individuals that comply with state cannabis laws. Thus, federal policy on cannabis banking could turn more hawkish.

Professor Hill stressed that, as long as cannabis is illegal under federal law, financial institutions that accept cannabis customers are taking a risk. In her view, the only sure solution is for Congress to legalize cannabis, blocking punishment of financial institutions that serve the industry.

Representatives of financial institutions described to the CBWG the obstacles to cannabis banking. Julie Robinson, a senior vice president at River City Bank in Sacramento, testified that the illegality of cannabis under federal law, the weaknesses of the Cole Memorandum and FinCEN Guidance, the burdensome requirements to monitor cannabis customers, the uncertain stance of regulators, and the statements of Attorney General Sessions are “roadblocks” that keep her bank from doing business with cannabis customers.

Sundie Seefried, CEO of Partner Colorado Credit Union in Arvada, Colorado, agreed that these obstacles make cannabis banking difficult, but her institution has made a commitment to taking on cannabis businesses. Partner Colorado has set up a special unit for cannabis customers, which, according to Seefried, has successfully passed regulatory examinations. Seefried stressed cannabis banking only works when an institution commits substantial resources and staff time to compliance, which means going the extra mile to watch over cannabis customers to make sure they obey state cannabis laws and stay within federal guidelines.

These difficulties mean that the industry has been largely locked out of the banking system. Cannabis businesses are often unable to carry out routine functions other businesses take for granted, like having a deposit account, taking credit or debit cards, paying landlords and vendors by check or ACH transfer, and using payroll services.

The CBWG heard from cannabis business owners about the methods they are forced to use to get banking services, like opening accounts without telling financial institutions the real nature of their businesses. Others described using personal accounts to pay business expenses. Sooner or later, the large sums of cash they deposit raise suspicions. On other occasions, financial institutions learn the true nature of the business in other ways. In either case, their accounts are closed, forcing them to jump to another institution down the street and repeat the process. Others throw up their hands and try to run their businesses entirely on a cash basis.

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**ROADBLOCKS TO CANNABIS BANKING**

- Cannabis remains illegal under federal law.
- The Cole Memorandum and FinCEN Guidance do not guarantee a safe harbor.
- The stance of regulators is uncertain.
- Federal guidelines impose burdensome requirements to monitor cannabis customers.
- Attorney General Sessions opposes the legalization of cannabis.
The difficulty of obtaining banking services is not just a hardship for cannabis businesses—it is a problem for everyone. By their nature, businesses that handle large sums of cash—not just cannabis businesses—are magnets for crime. Cannabis businesses and their employees face the greatest danger, but the large amounts of cannabis cash circulating in communities may represent a hazard for others as well. Government employees are vulnerable when they collect cannabis taxes and fees in cash, and the state’s taxpayers shoulder the extra cost of processing cash tax receipts. And being locked out of the banking system keeps many cannabis businesses in the shadowy world of the illegal market, where they may be untaxed and unregulated—precisely the opposite of what Proposition 64 intends.

Crime

The CBWG heard horror stories about crime and violence at all stages of the cannabis industry. Dispensary owners described armed robberies and the fear that hangs over them as they carry duffel bags full of currency through city streets to pay taxes. Others told of burying cash in back yards because it cannot be taken to a financial institution. Government officials and business people in California’s Emerald Triangle—the Mendocino, Humboldt, and Trinity County area in the state’s far northwest that is the nation’s largest cannabis-growing region—told of surges in home invasions and missing-person cases as the industry has grown. The news media tell grisly stories about murders and kidnappings of dispensary owners and guards. In remarks to the CBWG, public officials and cannabis industry representatives agreed: the only way to reduce the threat of violent crime is to open the banking system and take cannabis cash off the streets.

Inefficient, Insecure Revenue Collection

In an era when tax payments are made with cell phones and chip cards, cannabis businesses are throwbacks. Although some cannabis taxpayers find a way to pay electronically or by card or check, a significant number show up at state and local government offices with large sums of currency. That cash must be counted, stored securely, and transported to a financial institution—a single transaction may take hours to complete. Often the businesses have brought the money a long way. Above all, government agencies that collect this revenue must protect the safety of their staff members. Agencies sometimes remodel field offices to make them more secure and use armored cars to take funds to a financial institution. The expense in staff time, security, and facilities management make this a very costly way to collect revenue.

Taking Cannabis Out of the Illegal Market

For cannabis businesses, Proposition 64 represents a game-changing opportunity to step out of the shadows. The CBWG heard repeatedly from people in the industry how much it means to them to be able to operate normal businesses and no longer be outlaws. That transformation, which started with medical marijuana, promises major benefits to society. Normal businesses obey the law, pay taxes, and comply with environmental, consumer safety, and worker protection rules. They become contributing members of their communities. But if operating aboveboard is too dangerous because paying taxes is risky, if the cost is too high, or the hassle is too great, some in the industry may stay underground. When that happens, the state loses tax revenue and the public loses the protections that come when cannabis businesses are duly regulated.

“CASH IS THE MOTHER’S MILK OF CRIME.”
— Janet Sanchez, Humboldt County Community Credit Union

“CASH IS DIRTY, IT IS COUNTERFEITED, CASH SHRINKS, CASH IS EXPENSIVE AND TIME CONSUMING. CASH REPRESENTS RISK.”
— Todd Bouey, Los Angeles City Office of Finance
Cannabis Banking Not Only A California Problem: Finding a Solution to a National Dilemma

**Adult Recreational Use**
- Alaska
- California
- Colorado
- District of Columbia
- Maine
- Massachusetts
- Nevada
- Oregon
- Washington

**Medical Use**
- Arizona
- Arkansas
- Connecticut
- Delaware
- Florida
- Hawaii
- Illinois
- Maryland
- Michigan
- Minnesota
- Montana
- New Hampshire
- New Jersey
- New Mexico
- New York
- North Dakota
- Ohio
- Pennsylvania
- Rhode Island
- Vermont
- West Virginia

**Limited Medical Marijuana**
- Alabama
- Georgia
- Iowa
- Kentucky
- Louisiana
- Mississippi
- Missouri
- North Carolina
- South Carolina
- Tennessee
- Texas
- Utah
- Virginia
- Wisconsin
- Wyoming

*Limited medical marijuana includes cannabis extracts that are high in cannabidiol and low in tetrahydrocannabinol (THC)

Source: National Conference of State Legislatures (as of Oct. 18, 2017)
CANNABIS INDUSTRY ACCESS TO BANKING SERVICES

Four Potential Strategies

Based upon the findings of the CBWG, the State Treasurer’s Office believes that the best way to approach the problem of cannabis and banking is to think in terms of a series of steps, each of which involves greater access to banking services. The starting point is the current situation, with cannabis businesses operating extensively in cash and obtaining only sporadic access to banking services. The end point is federal legalization of cannabis or, if that is unachievable, legislation protecting financial institutions that serve the cannabis industry. These reforms would let cannabis businesses open accounts and handle payments normally, like other regulated businesses. Between the current situation and federal legalization are a series of strategies to help the cannabis industry.

This report considers strategies in four areas:

- making collection of taxes and fees safer and more efficient;
- expanding cannabis access to banking under current law;
- setting up a state-backed financial institution to serve cannabis clients;
- working to change federal law.

The first three strategies are not solutions. Rather, they are stopgap measures to protect public safety, improve revenue collection, and bolster the safety and efficiency of the cannabis industry until federal law is changed.

Some involve products and services marketed by private sector vendors to government agencies, cannabis businesses, or financial institutions. The CBWG and the State Treasurer’s Office do not endorse any specific product or service, and emphasize that vendors should be selected with care. (See Appendix for questions to ask vendors.) In particular, cannabis businesses should be wary of claims that a product or service definitively “solves” the problem of banking access. All strategies are limited by the status of cannabis under federal law. This report examines the pros and cons of a variety of approaches below.

WHY CANNABIS BANKING IS IN THE PUBLIC INTEREST

Controlling crime and threats to public safety stemming from the cash nature of the cannabis industry

Minimizing workload, expense, and security threats to state and local government revenue-receiving agencies

Establishing the cannabis industry as a transparent, regulated, tax-paying part of California economy
1. CASH HANDLING FOR THE COLLECTION OF TAXES AND FEES

The first problem the CBWG considered concerns how to make cannabis industry cash payments of taxes and fees safer and more efficient. These revenue collection strategies do not expand banking access in that they don’t depend on cannabis businesses obtaining accounts at financial institutions. Rather, they involve alternative methods of handling cash in place of hand delivery of currency to state and local government offices.

These alternatives should be judged according to several standards:

- Do they protect the safety of cannabis business employees and government agency staff?
- Are they geographically dispersed to minimize transportation of cash?
- Are they able to handle large dollar volumes?
- Are they able to handle multiple tax and fee payer accounts easily?
- Do they minimize risk of loss to revenue-receiving agencies?
- Do they permit agencies to deposit funds in financial institutions?

Financial institution policies may complicate collection of tax and fee payments in cash from cannabis businesses. Most financial institutions do not accept deposits of funds that come directly from a cannabis business and will not knowingly open accounts for cannabis businesses. However, they do accept deposits of taxes and fees by state and local governments, which may include legal cannabis payments.

Cash handling strategies described here are not mutually exclusive, but may be used in combination. For example, electronic equipment for collecting cash payments requires periodic armored courier pickups. Businesses providing payment services also use couriers and may offer compliance services too.

A key consideration is whether a payment method is able to handle large or high-volume transactions. Some cash payment methods may not be able to function on the scale needed to process cannabis industry payments.

The CBWG recognizes that government revenue collecting agencies and financial institutions have different and, at times, conflicting concerns. To fulfill their mission the agencies must sometimes handle large sums of cash. Financial institutions have a responsibility to customers and shareholders to prudently manage risk associated with accepting large volumes of cash. Meanwhile, the safety of everyone involved in cash transactions must be the foremost concern of all parties. And, government officials must fulfill their responsibilities to collect taxes due them.

A strategy for handling taxes and fees paid in cash should be judged based on whether it protects the safety of government and financial institution employees, tax and fee payers, and other members of the public. At the same time a strategy cannot rely on interpretation or uncertainty by the financial institution on its risk management strategy. By interacting directly with the taxpayer and not requiring financial institutions to make repeated and situational determinations about the source of the cash being deposited, the state can meet its responsibilities to collect taxes and in a manner that protects the safety of the public.

A strategy should not depend on cannabis businesses having financial institution deposit accounts. Cannabis businesses must be able to pay taxes and fees without such accounts.

In addition, when it comes to paying taxes and fees, one size does not fit all. Whatever strategy is adopted, revenue collecting agencies should identify alternative payment methods, which may include:

- (1) establishing maximum cash payment amounts;
- (2) joint collection facilities where payments can be made to multiple agencies at a single location;
- (3) less costly courier services; and
- (4) money service businesses that accept small payments, a method recognized by the Internal Revenue Service for payment of federal income taxes.

**Smart Safes & Kiosks**

Smart safes are electronic cash collection machines resembling ATMs that take and count currency, make sure bills are genuine, and credit cash received to specified accounts. The safes are bolted to the floor, connected to the Internet, and monitored by security camera. Cash placed in a smart safe must be picked up periodically and deposited in a financial institution or Federal Reserve branch.

One option would be for state and local government agencies to install smart safes in offices that collect tax and fee payments. Agency staff would accept cash payments and feed currency into a safe. Each agency would have to develop guidelines regarding payment size and scheduling based on its particular needs. The smart safe would make crediting payments more efficient, but would not reduce potentially hazardous transportation of cannabis cash to government offices. Staff time would still be needed to receive cash and load safes.

An alternative might be to encourage installation of smart safes in dispensaries and other cannabis businesses. It is
technologically possible to earmark cash deposited in a smart safe for paying a cannabis business’s tax and fee obligations with multiple government agencies. A cannabis business would feed cash into a smart safe on its premises that has been programmed to pay taxes and fees. An armored courier service would pick up the cash and deposit it at financial institutions that accept cannabis deposits. In other cases, the courier service would first bring cannabis cash to revenue-receiving agencies for processing with other tax receipts, provided such an arrangement was feasible for the agency. The cash would then be transported for deposit to agency bank accounts.

Kiosks at cannabis retail locations could perform some of the same functions, but also serve as retail vending machines. Customers could pay for products with cash or stored value cards. Kiosks could be programmed to send excise tax and fee information to government agencies.

As noted, most financial institutions do not accept cash tax and fee payments delivered directly from cannabis businesses, but do accept state and local deposits of taxes and fees. At these institutions, cannabis payments must be mixed with other tax and fee deposits. These logistical complications might require extra armored courier trips and staff time, increasing costs and reducing efficiency.

**PROS:**
- If safes are located on-site at cannabis businesses, armored couriers would transport cash, protecting retailers and government employees from crime.
- The equipment counts and verifies cash deposits, saving staff time.
- Government agencies get regular tax and fee payment reports, and cannabis businesses get full payment documentation, creating an audit trail.
- Once cash is deposited in a safe, equipment vendors, not government agencies, absorb risk of loss.
- Cannabis businesses would pay all or most of the cost of equipment installed on their premises.
- Smart safes can be expensive and impose fees for maintenance and reporting, which may not be cost-effective for businesses.
- Equipment at cannabis locations could involve delays in crediting receipts to government agencies.
- Equipment requires frequent armored pick-ups, increasing overall cost.

**CONS:**
- Smart safes and kiosks may not be suitable for large dollar volumes.
- Standardizing data formats from various state and local agencies may prove difficult.
- Most financial institutions refuse to take currency delivered directly from cannabis businesses, requiring government agencies to mix cannabis payments with taxes and fees from other businesses.

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**Armored Courier Services**

Armored couriers pick up tax and fee payments in cash and deliver the funds to financial institutions. Under this option, armored couriers would pick up tax receipts on behalf of the state, and transport those receipts to a secure counting and verifying facility. Once the cash is counted it can

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“TO PAY MY TAXES, I HAVE TO USE A SIX- STORY PARKING STRUCTURE 500 YARDS FROM THE [LOCAL] OFFICE OF FINANCE AND WALK THROUGH A HOMELESS ENCAMPMENT WITH A DUFFLE BAG FULL OF CASH.”

— Jerred Kiloh, United Cannabis Business Alliance
be delivered to the Federal Reserve Bank or a financial institution accepting state deposits. The state's account would be credited electronically. With this option, safety is improved. Banks are not required to engage in activities that expose them to risk they are unwilling to take. Taxpayer compliance is enhanced and the will of the people expressed in the adoption of Proposition 64 will be served. This strategy does not depend on cannabis businesses having financial institution deposit accounts. Cannabis businesses would be able to pay taxes and fees without such accounts.

**PROS:**
- Couriers can accept large sums at each stop.
- Couriers are safe, relieving cannabis businesses and government personnel of the risks of cash transactions.
- Agency staff do not need to collect and count cash.
- Some couriers provide reporting and accounting services that can be used for regulatory compliance.

**CONS:**
- Some couriers will not pick up at cannabis facilities or may be prohibited from handling cannabis proceeds by the terms of federal licenses or contracts.
- The cost of courier operations may rise and efficiency may be reduced because of measures needed to make deliveries of cannabis cash acceptable to financial institutions.
- Armored couriers can be costly, depending on frequency of pick-ups and whether they are regularly scheduled or on demand.
- Couriers may not be suitable for small tax and fee payments.

**Money Services Businesses**

Money services businesses are a type of regulated financial company that sells money orders and electronic money transmission services. These businesses operate under a variety of brand names and the services they provide vary. Many cannabis businesses use money transmission services located near them in storefront offices or retail establishments such as drug stores and convenience stores to pay taxes and fees. Typically, the cannabis business uses cash to buy a money order or make an electronic money transfer to a government agency. In some cases, government agencies have accounts with money transmitters that permit electronic tax and fee payments. For example, the IRS collects cash federal income tax payments this way. Alternatively, money transmitters may transfer funds to a government agency account at a financial institution.

Money services businesses, including transmitters, are subject to anti-money laundering and anti-terrorism laws, and must follow FinCEN guidelines. Most money services businesses will not knowingly accept money from cannabis businesses because it is impossible to be sure the funds did not come from illegal activity. However, if cash amounts are small, few questions may be asked and customers may not have to identify where funds are from. As a result, many smaller cannabis businesses use money transmitters to pay taxes and fees.

**PROS:**
- Government agencies may get electronic credit to accounts set up with certain money transmitter services or to their accounts with financial institutions, minimizing handling costs.
- Cannabis businesses must take cash to money service business locations.
- Payment amounts are limited, making these services unsuitable for businesses with large tax bills.
- State and local government agencies may have to open accounts with these services.
- Money transmitters generally will not knowingly take funds from cannabis businesses.

**Third-Party Payment Services**

Third-party payment services that allow cannabis businesses to make electronic payments may in some cases be an option for settling tax and fee obligations. These services are electronic payment networks similar to PayPal. To make payments, a cannabis business must open an account with the service. The services use armored couriers to pick up cash from cannabis businesses, crediting funds to the business's payment service account. The business can then make and receive payments from other organizations and individuals that also have accounts with the service.

A system is known as "closed loop" if payments can only be made within the network, that is, among organizations and individuals that have accounts with the service. However, some payment services are "open loop," meaning they can also generate payments outside the network.
which may let cannabis businesses pay taxes and fees electronically. To do this, a cannabis business would use the Internet to initiate a tax or fee payment. The payment service would debit the cannabis business’s account and then draw on its own account at a financial institution to issue a check or make an ACH transfer to the revenue-receiving agency.

Like money transmitters, payment services are licensed and regulated money services businesses. A few payment services have specifically designed their operations to serve the cannabis industry. To stay within the law and avoid violating federal anti-money laundering regulations, these services must comply with federal know-your-customer rules and disclose their cannabis business line to their financial institutions.

Third-party payment services may also provide cannabis consumers ways to make purchases using technology like stored value cards and smart phones in place of cash. Consumers would have to open their own accounts with the services to make electronic payments.

**PROS:**
- Open-loop payment services may allow cannabis businesses to make tax and fee payments electronically.
- Transactions are recorded electronically, providing a complete digital record that assists regulatory compliance.
- Payment service may also provide electronic alternatives to cash, such as stored value cards and smart phones, for retail cannabis sales.

**CONS:**
- Third-party payment services that don’t disclose sources of cash to their financial institutions may involve cannabis businesses in money laundering violations.
- Closed-loop payment services are unable to generate payments outside the network.

**STATE TREASURER’S OFFICE RECOMMENDATION:**
The state taxing agencies should work with the State Treasurer’s Office and financial institutions to contract with an armored courier service that will collect state tax and licensing payments made in cash from businesses in California, including cannabis businesses, that do not have deposit accounts. On behalf of the state, the armored couriers would pick up cash from the businesses and transport those receipts to a secure counting and verifying facility before taking the cash payments to either a Federal Reserve facility or a financial institution willing to accept the cash as deposits to state accounts. Armored courier services would eliminate the need to directly handle large sums of cash at branch offices or open deposit accounts at financial institutions while easing know-your-customer requirements because the state would be the customer. Such an arrangement would address a number of barriers to the collection of tax and fee payments, and result in increased safety, would not require banks to engage in activities that expose them to greater risk than they are willing to take, and increase taxpayer compliance. The Treasurer’s Office and state agencies should identify the appropriate contractors for this service and specify which parties would be responsible for paying. State agencies should offer this option to local government units through partnerships or similar arrangements, which would permit collection of local taxes and licensing fees, provided that statutory authority exists and a method is established for local agencies to pay the costs of the service.

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**RECOMMENDATION: THE CASH HANDLING JOURNEY**
**How a Local Cash Business Pays State Taxes & Fees**

1. **Courier Picks Up Tax and Fee Payments From Business, Including Cannabis Vendor**
2. **Courier Takes Payments to Federal Reserve or Designated Financial Institution**
3. **Federal Reserve or Designated Financial Institution Deposits Money into State Account**
4. **State Transfers Money to Taxing Authorities**
2. EXPANDING CANNABIS INDUSTRY ACCESS TO BANKING SERVICES UNDER CURRENT LAW

The second issue in expanding cannabis industry access to banking concerns how to increase services to the industry while cannabis is still illegal under federal law. This involves finding ways to help cannabis businesses open accounts at banks, thrifts, credit unions, or other insured depository institutions under current federal laws and regulations.

Cannabis banking already exists in some of the states that have legalized adult recreational use. A handful of state-chartered banks and credit unions in Washington State, Colorado, and elsewhere currently do business openly with cannabis customers under Cole Memorandum and FinCEN guidelines. It is probable that some California institutions will open their doors to cannabis too, if they have not already done so. The challenge is that the capacity of institutions prepared to accept cannabis customers is woefully short of demand, which makes it vital to expand the industry’s bridgehead into banking rapidly. That goal can be achieved by ensuring financial institutions have the tools and data they need to navigate the narrow path open to cannabis banking under current federal policy.

Compliance Tools

It is possible for financial institutions to serve cannabis businesses now, but it is not easy. To accept cannabis customers, financial institutions must comply with the rigorous monitoring and reporting requirements of the Cole Memorandum and FinCEN Guidance. Institutions must make sure cannabis businesses are not violating state laws or engaging in activities the Cole Memorandum cites as law enforcement priorities. For each cannabis customer, financial institutions must complete special money laundering and suspicious activities reports. These are onerous requirements that demand extensive staff time.

“THERE IS NOT A SINGLE SOLUTION THAT WILL WORK IN ALL CIRCUMSTANCES.”
— Jim Kelly, First Data Corporation

The burden can be eased if financial institutions are able to obtain detailed information on each cannabis customer formatted to fit the institution’s regulatory reporting requirements. Financial institutions say the single most important step California can take to encourage cannabis banking under current law is to provide them comprehensive licensing and regulatory data on cannabis businesses. This material should include business licensing and registration documents, information on key business personnel, inventories of products sold, sources of supply, vendor relationships, financial records including major transactions, ongoing regulatory activity including citations for violations, and evidence of suspicious or illegal activities.

The Washington State Liquor and Cannabis Board shares application, registration, and regulatory information with financial institutions, and requires cannabis businesses to sign waivers allowing it to transmit confidential financial information. The program is often cited as a model for state information sharing.

California is implementing a wide-ranging regulatory program covering medical and adult recreational cannabis, including a comprehensive track-and-trace monitoring system. Access to this data will be essential to financial institution compliance programs, but sharing it is complicated by the state’s complex regulatory framework. In California, local governments have important licensing and revenue collection authority, and several state agencies have a role in supervising the industry. Because of these multiple lines of authority, the Washington State system would not work in California. The state and local governments must design a system for providing compliance information to financial institutions, working cooperatively with local governments. It should design its cannabis data collection and recordkeeping procedures with financial institution regulatory requirements in mind.

The California State Association of Counties (CSAC) is developing a Joint Powers Authority to create a platform that will standardize data collection and combine local information into a single database. This database will provide a central location for licensing data, product
tracking, and point of sale information. It could help local governments implement regulatory programs, and provide critical compliance data to financial institutions.

Numerous private businesses, including some money services and armored courier firms, sell recordkeeping and compliance services to financial institutions serving cannabis customers. Typically, these businesses offer a suite of products and services, which may include armored couriers and electronic payment systems in addition to compliance assistance. Private compliance services may be useful in some cases, but third parties cannot substitute for a financial institution’s own compliance efforts.

**PROS:**
- Compliance tools encourage financial institutions to serve cannabis customers by providing them know-your-customer data needed to meet anti-money laundering requirements and comply with federal cannabis banking guidelines.
- State and local government programs designed to share licensing and regulatory information give financial institutions access to comprehensive databases on cannabis businesses, which may be invaluable resources for compliance.
- Private sector compliance services are often linked with other important services, like armored courier and payment services.

**CONS:**
- Compliance tools can’t guarantee cannabis customers aren’t violating the law or engaging in activity prohibited by the Cole Memorandum.
- Regulatory standards are not uniform, but can vary from one regulatory agency or examiner to another. One-size-fits-all compliance tools may not satisfy all regulators.
- Because cannabis is illegal under federal law, compliance programs do not eliminate risk of federal enforcement action or changes in regulatory policy.
- Private compliance services can be expensive.

**STATE TREASURER’S OFFICE RECOMMENDATION:**
The State of California and local governments should create an online portal aggregating data on cannabis businesses from local government units and all 11 state agencies with cannabis regulatory or data-collection responsibilities. The portal should be designed with financial institution compliance needs in mind and provide material to help institutions fulfill their know-your-customer responsibilities. The data should include licensing and regulatory information, data on key personnel, product lists, sources of supply, financial records including major transactions, ongoing regulatory activity including citations for violations, adverse comments, and evidence of suspicious or illegal activities, provided such material is not restricted by disclosure rules or other agreements.
3. A STATE-BACKED FINANCIAL INSTITUTION

The third strategy examined by the CBWG is creating a state-backed financial institution in California to serve cannabis businesses directly or provide assistance to financial institutions that serve such businesses. Such an institution could be owned in whole or in part by the state. Alternatively, it could be privately owned but receive a special charter and privileges from the state.

The risks associated with a public financial institution would depend on its ownership structure. A combination of public and private ownership, or a privately owned institution with a special state charter similar to the federal Fannie Mae and Freddie Mac models, would pose less risk to taxpayers than 100 percent public ownership.

CBWG panelists described two variations of a state-backed financial institution model:

- A public institution that would either (1) finance public infrastructure and expand banking for underserved groups, including the cannabis industry; or (2) take deposits, make loans, and provide other services primarily to cannabis producers, distributors, retailers, and related businesses.

- A privately owned bankers’ bank, supported by the state, which would not take retail or small business deposits, but instead provide financial services, compliance services, and technical assistance to financial institutions serving the cannabis industry.

The merits of a public financial institution with a wide-ranging mission to finance public projects and target underserved groups is beyond the CBWG’s scope and the Working Group does not take a position on the matter. The Working Group focused instead on the narrower question of whether some form of publicly owned or state-backed financial institution represents a practical strategy for expanding cannabis banking.

To effectively allow the cannabis industry to deposit cash, a financial institution would need offices throughout the state. Thus, an extensive branch network would be an important element of any public banking strategy to cut the flow of cannabis cash. Like private financial institutions, a public financial institution serving the cannabis industry would require a comprehensive program to comply with federal anti-money laundering and anti-terrorism rules, and cannabis banking guidelines.

Public Financial Institution

A state institution would be organized and capitalized by the state, and owned by the taxpayers of California. Such an institution could have a broad charter to take deposits from consumers and small businesses, lend money for development of underserved communities, and finance infrastructure projects. Serving the cannabis industry would be one of its missions.

Alternatively, a public financial institution could primarily serve the cannabis industry. It could be organized as a freestanding institution or as a separately chartered unit of a broader public institution. Its mission would be to provide deposit, credit, and payment services to cannabis businesses. Like a broader public financial institution with a cannabis business line, it would need a statewide branch network and a robust compliance program.

Currently, the Bank of North Dakota is the nation’s only deposit-holding publicly owned financial institution. Established in 1919 to provide credit to farmers, the bank is a fiscal agent for state government and a bankers’ bank that does funds management and provides other services to private financial institutions. It has one office and offers limited retail banking services. Bank of North Dakota deposits are insured by the state because FDIC rules make it hard for public institutions to obtain deposit insurance.

Massachusetts studied setting up a public bank several years ago. David Cotney, former commissioner of the Massachusetts Division of Banks, told the CBWG that the state decided not to create a public bank because of the inability to get deposit insurance, start-up costs estimated at $3.6 billion, and the probability of losses for several years that taxpayers would have to cover.

A public institution’s cannabis lending activities may face a special threat. One of the risks cannabis businesses face is the possibility of asset forfeiture, that is, that federal law enforcement officials might seize their assets. Since assets such as business property might be used as collateral on loans, a bank lending to a cannabis customer would have no recourse if the property were forfeited.

Whether a public institution that served the cannabis industry could get federal regulatory approval is also a serious concern. The institution’s primary mission would be to serve an industry illegal under federal law. In addition, regulators disapprove of financial institutions that are overly concentrated in one industry because the fortunes of those institutions are too closely tied to the industries they serve. An institution would be in danger of failing if its industry experienced a downturn.

Access to interbank funds transfer systems could be a special problem. If the Federal Reserve refuses to give a public institution a master account granting it access to...
funds transfer systems like ACH, the institution would be fenced off from the rest of the banking system. In that case, it wouldn’t be able to clear checks, carry out wire or ACH funds transfers, or process credit and debit cards. Essentially, it would become a closed-loop system in which customers could only exchange funds with other customers of the institution.

In a well-known case a few years ago, the Federal Reserve denied a master account to Fourth Corner Credit Union, an institution chartered by Colorado to serve the cannabis industry. A federal court dismissed Fourth Corner’s lawsuit seeking an order requiring the Federal Reserve to give it an account.

**CONS:**

- A public financial institution would take a long time to organize and wouldn’t be ready when adult recreational cannabis becomes legal at the beginning of 2018.
- A public financial institution would probably not qualify for FDIC or National Credit Union Administration deposit insurance, which would require the state to self-insure.
- Depending on the size of the institution created, start-up and capitalization costs could total billions of dollars.
- Losses could be substantial, especially at the beginning, requiring years of subsidy.
- To effectively bank the cannabis industry, an institution would have to operate throughout the state, increasing costs.
- If a public financial institution served the cannabis industry, it might not be able to get a Federal Reserve master account, hampering its ability to transfer funds.
- A cannabis institution runs the risk that collateral on its loans could be forfeited.
- A financial institution primarily serving cannabis businesses would be vulnerable to an industry downturn.

**Bankers’ Bank**

A bankers’ bank is a private financial institution whose customers are other banks. It provides services like credit card processing and money transfer facilities to small institutions that aren’t able to manage such operations themselves. In the credit union industry, such an institution is known as a corporate credit union. By affiliating with a bankers’ bank or corporate credit union, small institutions are able to offer broad sets of products and services to their own customers, taking advantage of economies of scale.

California could encourage creation of a private bankers’ bank or corporate credit union with the mission of supporting financial institutions serving the cannabis industry. Such a bank or credit union would serve as a storehouse of information on cannabis banking. It could help financial institutions put in place programs to comply with Cole Memorandum and FinCEN guidelines, give technical assistance in know-your-customer and reporting processes, and make sure institutions follow best practices in cash handling, payments, and other banking operations. In addition, such an institution could develop a template to standardize financial institution compliance operations.

**TWO VIEWS:**

“A STATE BANK WOULD CREATE DEPOSITORY SERVICES [FOR CANNABIS RELATED BUSINESSES] AND ALSO FOR COMMUNITIES AND STAKEHOLDERS WHO HAVE BEEN UNDERSERVED BY THE BANKING COMMUNITY.”

– Matt Stannard, Commonomics, USA

“IN REGARDS TO PUBLIC BANKS, OWNERSHIP IS NOT AN EXEMPTION, ALL BANKS ARE SUBJECT TO FEDERAL LAW.”

– Don Childears, CEO
Colorado Bankers Association
“THE EMERGENCE OF THE MULTI-BILLION DOLLAR CANNABIS INDUSTRY COULD WELL BE THE CATALYST THAT VAULTS PUBLIC BANKING INTO BECOMING A REALITY. WE ARE HERE TO TEST THE IDEA TO SEE IF IT IS TRULY WORKABLE. IS THERE SOMETHING REALLY THERE? OR IS IT LIKE A POTATO CHIP? TASTY TO EAT, BUT ULTIMATELY NOT MUCH NUTRITIONAL VALUE?”

— State Treasurer John Chiang
What the role of the state would be in creating a cannabis bankers’ bank or credit union remains to be defined. One model could be to grant the institution a special charter.

**PROS:**
- A bankers’ bank or credit union would centralize expertise regarding best practices in cannabis banking.
- It would allow financial institutions to offer products and services to the cannabis industry they might not be able to provide on their own.
- It could help standardize financial institution compliance operations.

**CONS:**
- It might be difficult to design a business plan that would become profitable quickly.
- If such an institution only provided services for cannabis banking, it might be subject to the same regulatory restrictions as a public cannabis bank.
- Other financial institutions might not be able to take advantage of a bankers’ bank or credit union services because of federal legal restrictions against cannabis banking.

**STATE TREASURER’S OFFICE RECOMMENDATION:**
A feasibility study should be conducted to determine whether creation of a public cannabis financial institution or a bankers’ bank or corporate credit union is advisable. The study should consider costs, benefits, risks, and regulatory issues, including capitalization, deposit insurance, and access to interbank funds transfer systems. It should also examine various ownership structures, including appropriate mixes of public and private capital. The feasibility study should include a legal analysis addressing the legality and associated legal risks of creating a public cannabis financial institution, including, but not limited to, whether such an institution can be created without violating federal law, the extent to which it would remain subject to federal oversight and regulation, and whether tax revenues deposited in it could be at risk of seizure by the federal government.

### ANNUAL U.S. CANNABIS SALES VS OTHER INDUSTRIES & GOODS

<table>
<thead>
<tr>
<th>Product</th>
<th>Estimated Total Demand for Recreational Cannabis in the U.S.</th>
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<tbody>
<tr>
<td>Beer</td>
<td>$106.0B</td>
</tr>
<tr>
<td>Cigarettes</td>
<td>$76.9B</td>
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<tr>
<td>Nutraceuticals*</td>
<td>$70.3B</td>
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<tr>
<td><strong>Estimated Total Demand for</strong></td>
<td><strong>$45 - $50B</strong></td>
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<td><strong>Recreational Cannabis in the U.S.</strong></td>
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<td>Movie Tickets*</td>
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<tr>
<td>Ice Cream (Retail)</td>
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<tr>
<td>Dorritos, Cheetos, &amp; Funyuns</td>
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<tr>
<td>Frozen Pizza</td>
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<tr>
<td><strong>Legal Recreational &amp; Medical</strong></td>
<td><strong>$4.0 - $4.5B</strong></td>
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<td><strong>Cannabis in 2016</strong></td>
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<td>Paid Music Streaming Services</td>
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<td>Tequila</td>
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</tr>
<tr>
<td>Girl Scout Cookies</td>
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</table>

*Includes U.S. and Canada. Source: Marijuana Business Daily

Notes: Source for information in graph is the following: Brewers Association, IRI, Mordor Intelligence, MPAA, Statista, Eli Lilly and Company, Pfizer, RIAA, U.S. Distilled Spirits Council. All data is for 2015 or 2016, most recent figures are reported in the chart.
4. FULL ACCESS TO BANKING SERVICES: THE FEDERAL SOLUTION

The final step in providing banking services to the cannabis industry is removing federal legal and regulatory roadblocks. This is the end game which would allow cannabis to be treated like other cash-intensive regulated industries, such as casinos and pawnshops. Financial institutions would be free to bank state-legal cannabis businesses as long as those institutions complied with anti-money laundering and anti-terrorism requirements. With access to banking services, cannabis businesses would be motivated to move away from cash—for convenience, efficiency, transparency, to ease compliance with state regulations, and, above all, to protect the safety of business owners, employees, and customers.

The road to removal of federal restrictions is long and hard. It demands policy changes by Congress, the executive branch, and regulatory agencies. During the Obama administration, the federal government moved in that direction. Deputy Attorney General David Ogden issued a memorandum instructing federal prosecutors to make enforcement action against state-legal medical marijuana a low priority. The Justice Department followed with the Cole Memorandum and the Treasury Department with FinCEN Guidance, which opened the door to cannabis banking. The FDIC and other regulatory agencies were not parties to those guidelines, but they generally did not stand in the way as a few financial institutions accepted cannabis business customers.

Congress reached a major milestone in 2014 when the House of Representatives approved a budget amendment introduced by California Reps. Dana Rohrabacher and Sam Farr barring the Justice Department from spending money to block state medical marijuana programs. The amendment, the first federal legislation to support state cannabis programs, was renewed in 2015 and again in 2017.

Now though, the executive branch has taken a step backward, at least rhetorically. Attorney General Sessions has criticized state marijuana laws and called for strict enforcement of federal drug laws. And he has spoken out against congressional restrictions against prosecuting state-legal cannabis businesses or consumers. Congress ultimately must decide whether to renew the constraints despite objections by the attorney general.

Current legislation to tear down obstacles to cannabis banking follows three tracks. One approach, represented by the Secure and Fair Enforcement Banking Act, introduced by Rep. Ed Perlmutter of Colorado, would provide a legal safe harbor to financial institutions by prohibiting federal prosecutors or regulators from penalizing them for serving cannabis customers that comply with state law. A second approach would legalize cannabis by taking it off the list of Schedule I controlled substances. A third strategy would bar federal officials from prosecuting cannabis consumers and businesses in states that have approved medical or adult recreational use. The proposed Respect State Marijuana Laws Act, sponsored by Rep. Rohrabacher, is an example. In remarks to the CBWG, Rep. Rohrabacher urged Working Group members to press Congress for passage of his bill and other legislation that would remove federal obstacles to state cannabis laws.

Twenty-nine states and the District of Columbia have approved medical cannabis or both medical and adult recreational cannabis. As more states join the bandwagon, the momentum for changes in federal policy builds. The strategies described in this report are stopgap measures pending removal of federal barriers to cannabis banking. The problem of cannabis access to banking services won’t be definitively solved until federal policy is no longer an impediment. It is essential that California work with other states and stakeholders to make sure these obstacles come down.

STATE TREASURER’S OFFICE RECOMMENDATION:

A multistate consortium should be created which includes representatives of cannabis-legal states, local governments, the cannabis and financial services industries, and law enforcement. The consortium would have a three-part mission: (1) education and outreach to ensure that opinion leaders and the public understand state cannabis policies and the problem of banking access; (2) maintaining a central repository for information on state cannabis laws, including lessons learned; and (3) congressional and executive-branch policy advocacy, which should be coordinated to make sure that cannabis-legal states speak with one voice.
Opening the banking system is an essential part of California’s bold effort to build a safe, legal, transparent, and responsible cannabis industry in the state. Even the best regulatory program won’t succeed unless cannabis businesses are allowed to become law-abiding, tax-paying members of their communities. But it is hard for cannabis businesses to make that commitment if they can’t write checks, take credit cards, and move money like any other business. It is a challenge to ensure cannabis businesses obey the law if they mainly use cash. In this respect, banking is integral and critical to successful implementation of Proposition 64.

California has exercised national leadership in areas ranging from climate policy to social legislation. The state has an opportunity to be a pacesetter once again by meeting the challenge of cannabis banking head on. Doing so will help make not just the state, but the entire nation, safer and more economically vibrant.

“CALIFORNIA IS ENTERING A NEW ERA WITH THE LEGALIZATION OF ADULT RECREATIONAL CANNABIS. CALIFORNIA HAS EXERCISED NATIONAL LEADERSHIP IN AREAS RANGING FROM ENHANCING CIVIL RIGHTS TO PROTECTING THE ENVIRONMENT. THE ARRIVAL OF LEGAL ADULT RECREATIONAL CANNABIS OFFERS ANOTHER OPPORTUNITY FOR OUR STATE TO SET AN EXAMPLE. I AM CONVINCED WE CAN FIND WAYS TO EXPAND CANNABIS INDUSTRY BANKING ACCESS AND MAKE PROPOSITION 64 A SUCCESS.”

— State Treasurer John Chiang
from strict enforcement of federal

shift of government priorities away
memorandum represented a significant
other adult use of marijuana. The
states that had legalized medical or
priorities for federal prosecutors in
Department memorandum issued in
outside the network.

Open-loop systems can make payments
accounts in the payment service network.
organizations and individuals that have
only allow payments to be made to
Systems –

Closed-Loop and Open-Loop Payment
institutions. It allows credits such as
direct payroll deposits and debits such as
automatic bill payments to be executed
typically with a one-day delay. In 2013,
early 22 billion ACH transactions

Bankers’ Bank – A bankers’ bank is
private financial institution whose
customers are other banks. A bankers’
bank provides services like credit card
processing and money transfer facilities
to small institutions that aren’t able to
manage such operations themselves.

Bank Secrecy Act (BSA) – The BSA
was implemented to detect money
laundering and establishes requirements
for recordkeeping and reporting for
individuals and financial institutions.
The law’s purpose is to help identify
the source, volume, and movement of
currency and other monetary instruments
transported or transmitted into or out of
the United States or deposited in financial
institutions.

Closed-Loop and Open-Loop Payment
Systems – Closed-loop payment systems
only allow payments to be made to
organizations and individuals that have
accounts in the payment service network.
Open-loop systems can make payments
outside the network.

Cole Memorandum – A U.S. Justice
Department memorandum issued in
August 2013 describing a new set of
priorities for federal prosecutors in
states that had legalized medical or
other adult use of marijuana. The
memorandum represented a significant
shift of government priorities away
from strict enforcement of federal

marijuana prohibition toward a more
lenient approach.

Controlled Substances Act (CSA) –
The CSA, passed in 1970, defines federal
drug policy and classifies drugs based
on their potential for abuse. It prohibits
manufacture, importation, possession,
use, and distribution of narcotics and
other drugs considered dangerous,
including marijuana.

Fedwire – A real-time electronic system
for immediate funds transfers among
financial institutions, operated by the
Federal Reserve.

FinCEN Guidance – The Financial Crimes
Enforcement Network (FinCEN) is a bureau
of the U.S. Treasury Department charged
with preventing use of the financial
system for criminal purposes, combatting
money laundering, and protecting
national security. In 2014, FinCEN issued
guidance informing financial institutions
how they could permissibly serve
cannabis businesses in states that had
legalized marijuana.

Know Your Customer – Know Your
Customer guidelines are aimed at
preventing financial institutions from
intentionally or unintentionally engaging
in criminal money laundering. They
require financial institutions to conduct
in-depth due diligence on customers.

Medicinal and Adult Use Cannabis
Regulation and Safety Act
(MAUCRSA) – California law
implementing Proposition 64 and setting
up a regulatory system for both medical
and adult recreational cannabis.

Money Services Business – A money
services business is a type of regulated
financial company that sells money
orders and electronic money transmission
services. Money services businesses,
including transmitters, are subject to anti-
money laundering and anti-terrorism laws,
and must follow FinCEN guidelines.

Rohrabacher-Farr Amendment –
Federal legislation, first approved in 2014,
barring the Justice Department from
spending money to block state medical
marijuana programs. It was renamed the
Rohrabacher-Blumenauer Amendment
in 2016 after the retirement of one of its
original sponsors.

Safe Harbor Legislation – In the
context of cannabis policy, federal safe
harbor legislation would prohibit federal
prosecutors or regulators from penalizing
financial institutions that serve cannabis
customers complying with state law.

Smart Safe and Kiosk – Smart safes
and kiosks are electronic cash collection
machines that take and count currency,
and credit cash received to specified
accounts. Smart safes may also ensure bills
are genuine.

Stored-Value Card – A payment card
in which the value is stored in the card
itself. Payments can be made without
accessing a credit or debit account at
a financial institution.

Suspicious Activity Report (SAR) – A
FinCEN report prepared by a financial
institution regarding suspicious or
potentially suspicious activity. An
institution is required to file a suspicious
activity report when it detects or suspects
criminal violation of federal law or a
suspicious transaction related to money
laundering or a violation of the Bank
Secrecy Act. Financial institutions that
serve cannabis businesses are required to
file periodic suspicious activity reports.

Third-Party Payment Service –
A vendor that provides payment
processing services to businesses.
These services use their own financial
institutions to process these
payments and offer businesses
alternatives for accepting payments,
including checks, credit and debit card
transactions, and ACH transactions.
**APPENDIX: QUESTIONS TO ASK VENDORS**

Many private sector vendors offer cannabis-related payment, compliance, and cash handling services to cannabis businesses, financial institutions, and government agencies. The CBWG and the State Treasurer’s Office do not endorse any specific product or service, and emphasizes that vendors should be selected with care. In particular, cannabis businesses should be wary of claims that a product or service definitively “solves” the problem of banking access. All strategies are limited by the illegal status of cannabis under federal law. Here are some questions to ask when considering whether to use vendor services.

1. **Payment Services**
   - Can I pay third parties electronically or by check?
   - Do you inform your financial institution that cannabis businesses use your service?
   - Do you provide payroll services?
   - Do you comply with federal cannabis banking guidelines?
   - Can my customers get an electronic payment method for buying my products?
   - Are my suppliers on your network?
   - Can I make tax payments to state, federal and local governments?

2. **Smart Safe/Kiosk Vendors**
   - How often will cash in the safe/kiosk be picked up?
   - Can I use the safe/kiosk to pay multiple tax and fee obligations?
   - When will my tax and fee payments be credited?
   - Can I use the safe/kiosk for purposes besides tax and fee payments?
   - What are the requirements for installation?
   - Who bears the risk for deposits made into the safe/kiosk?
   - What are the costs?
   - Is maintenance included?

3. **Armored Couriers**
   - What is the cost per pickup?
   - Do you have a predetermined route?
   - Do I need to execute a contract with you?
   - Are pickups made on a regular schedule or on demand?
   - What is the maximum amount you will pick up?
   - How soon after pickup are amounts deposited into a financial institution?
   - Where do you deliver the cash?

4. **Money Services Business**
   - How much money can I transfer?
   - How often can I use the service?
   - What locations are available?
   - What paperwork is required?
   - How quickly will transfers be credited?
   - Does my payee need to have an account with you?
   - What are the costs and fees?
   - Can I make tax payments to state, federal, and local governments?

5. **Questions for All Vendors**
   - Do you specialize in serving the cannabis industry?
   - Do you provide compliance services that might help my business get a financial institution account?
   - What would happen to your business if the federal government cracks down on cannabis businesses?
   - How are deposit amount discrepancies reconciled?
   - What reports do you provide?
ACKNOWLEDGEMENTS

The State Treasurer’s Office appreciates the time and efforts of the following, who presented testimony at the six public meetings held around the state:

Alex Alanis, California Bankers Association
Donnie Anderson, California Growers Association
Kirk Anderson, CannaCraft
Julie Anderson Hill, University of Alabama School of Law
John Bartholomew, Humboldt County Treasurer-Tax Collector
Ricky Bennett, Blue Line Protection Group
Kenneth J. Berke, PayQwick
Phil Blarton, All About Wellness
Todd Bouey, Los Angeles City Office of Finance
Jim Brush, Summit State Bank
David Chelette, Iipay Nation of Santa Ysabel
Don Childears, Colorado Bankers Association
David Cotney, RateGravity
Adam Crabtree, Nationwide Compliance Specialists
Derek Davis, California Cannabis CPA
Joe DeVries, City of Oakland
Ali Fakhri, EventHi
Andrew Freedman, Freedman & Koski
Rick Garza, Washington State Liquor and Cannabis Board
David Gau, State Board of Equalization
Jay Goldstone, MUFG Union Bank
David Haithcock, California Community Banking Network
Gwendolyn Hallsmith, Global Community Initiatives
John Hudak, Brookings Institution
Jim Kelly, First Data Corporation
Joseph Kelly, Los Angeles County Treasurer-Tax Collector
Khurshid Khoja, California Cannabis Industry Association
Jerred Kiloh, United Cannabis Business Alliance
Kevin Klowden, Milken Institute
Lewis Koski, Freedman & Koski
Chuck Lowery, City of Oceanside
Jon Lunsford, California First Financial
Sumit Mehta, Mazakali
Casey O’Neill, California Growers Association
Cora Parker, Oregon State Treasury
Julie Robinson, River City Bank
Rep. Dana Rohrabacher, 48th Congressional District
Russell Rosendal, Salal Credit Union
Janet Sanchez, Humboldt County Community Credit Union
Sundie Seefried, Partner Colorado Credit Union
Aaron Smith, National Cannabis Industry Association
Matt Stannard, Commonomics USA
Michael Steinmetz, Flow Kana, Inc.
Larry Thacker, Caliva
Dante Tosetti, Independent Banking Consultant
John Vardaman, Hypur, Inc.
Steven Wildemuth, MUFG Union Bank
Lamine Zarrad, Tokken

Thank you to the following who gave input and assisted the members of the Working Group:

Marc Alviso, California Department of Tax and Fee Administration
Tim Cromartie, League of California Cities
Camille Dixon, California Department of Insurance

Benjamin Glickman, California Department of Justice, Office of the Attorney General
Charles Harvey, California Department of Justice, Office of the Attorney General
Chris Lee, California Department of Tax and Fee Administration
Jennifer Lee, California Department of Justice, Office of the Attorney General
Cara Martinson, California State Association of Counties
Kevin Matulich, California Employment Development Department
Tim Morland, California Board of Equalization
Laureen Phillips, California Franchise Tax Board

The Treasurer thanks staff who worked tirelessly in support of the Cannabis Banking Working Group:

Megan Batty
Shawn Brouwer
Vanessa Garcia
Mark Hariri
Blake Johnson
Eric Lawyer
Marc Lifsher
Mark Paxson
Andre Rivera
Tim Schaefer
Kim Stevens
Kristin Szakaly-Moore
John Wark
Collin Wong-Martinussen

Special thank you:

Design by Friday
Sam Zuckerman, Accessible Economics
CANNABIS BANKING WORKING GROUP MEMBERS

John Chiang  
California State Treasurer  
Chair, Cannabis Banking Working Group

Simone Lagomarsino  
California Bankers Association

David Haithcock  
California Community Banking Network

Courtney Jensen  
California and Nevada Credit Union League

Fiona Ma  
Board of Equalization

Nick Maduros  
California Department of Tax and Fee Administration

Patrick W. Henning Jr.  
Employment Development Department

Selvi Stanislaus  
Franchise Tax Board

Jan Lynn Owen  
Department of Business Oversight

Lori Ajax  
Bureau of Cannabis Control

Peter Williams  
Business Consumer Services and Housing Agency

Melanie Fontes Rainer  
Attorney General’s Office

Hezekiah Allen  
California Growers Association

Khurshid Khoja  
California Cannabis Industry Association

Nicole Howell Neubert  
Clark Neubert LLP

Matt Cate  
California State Association of Counties

Carolyn Coleman  
League of California Cities

Dave Jones  
California Department of Insurance