DEPARTMENT OF CONSUMER AND BUSINESS SERVICES: DIVISION OF FINANCIAL REGULATION

In Accordance with House Bill 4094 (2016)

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This report reviews the current state of the provision of depository and related financial services to businesses engaged in the legal production, processing and sale of marijuana and marijuana derived products.

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Executive Summary

It is difficult for marijuana-related businesses to obtain, and then maintain, depository and related banking services. Federal law, specifically the Controlled Substances and the Bank Secrecy Acts, make it illegal for financial institutions to offer services to marijuana-related businesses. Federal entities have issued various pieces of guidance meant to assure financial institutions that if they uphold their reporting responsibilities under the Bank Secrecy Act and ensure that the enumerated federal enforcement priorities are not implicated, they can offer services to the industry. However, the fact remains that doing so would technically be aiding in a violation of federal law. The parameters for federal prosecution are laid out in memoranda from the U.S. Department of Justice and Department of Treasury. How to avoid regulatory penalties is less clear and poses a significant threat to financial institutions. Federal and state regulators can downgrade institutions' ratings, require increased supervision and control, levy civil penalties, and bar institution executives from holding jobs in the financial sector. These are the things that unnerve financial institutions.

Financial institutions are subject to dual regulatory authorities: state and federal regulators. Federal regulators examine banks and credit unions for their safety and soundness to prevent damage to the financial system or respective deposit insurance fund. State regulators oversee state chartered institutions to ensure safe and sound operations and prevent consumer harm. State regulators examine for compliance with federal laws such as the Controlled Substances Act and Bank Secrecy Act (BSA) because violating federal law is an inherently unsafe practice. The guidance from the federal government regarding canna-businesses has been fairly consistent up to this point: it is possible to offer financial services to marijuana related businesses so long as BSA due diligence and reporting are strictly adhered to and special attention is paid to indications of interstate trafficking, criminal enterprise or black market participation, and selling to minors. The recent election, and announcement of presidential cabinet members, has cast doubt upon whether the previous policy stances will continue under the new administration. A number of potential cabinet members are hostile to marijuana and state cannabis legalization efforts.

State regulators have no jurisdiction over federally chartered institutions. Some large national financial institutions have expressly stated that they cannot and will not violate federal law by serving the cannabis industry. Institutions that have been serving the industry have largely been state-chartered credit unions and smaller community banks. Concentrating, in a few financial institutions, deposits subject to federal forfeiture due to a change in executive policy, is not a safe and sound management model. To avoid concentration of deposits, marijuana related deposits need to be distributed amongst various financial institutions. Conducting the enhanced due diligence required by the federal guidance requires substantial compliance resources – personnel, software, expertise. Institutions must assess the cost of providing services, the risk of administrative or criminal sanction, reputational risk, and develop policies and procedures to ensure that accounts will not implicate enforcement priorities. Where state or federal regulators do not actively support serving the industry, a board is more likely to decide against accepting deposits. Clear communication with regulators, in states with strong administrative and enforcement programs, may contribute to a higher percentage of financial institutions serving the cannabis industry.

Oregon's recreational marijuana program is still in the process of coming fully on-line. As marijuana related businesses are licensed and engaged with the seed-to-sale tracking database, financial institutions will have data which can be used to demonstrate that they are only providing services to businesses working within the state's rigorous regulatory scheme. Licensing and inspection, product tracking, testing, labeling and package requirements, and transparent financial trails should be effective in preventing:

- Sales to minors
- Trafficking marijuana or other drugs
- Cartel or bad actor involvement
- Increased violent crime and firearm usage in connection with marijuana
- Preventing growing and production on federal lands
- Preventing adverse public health consequences

However, until the regulatory protections are fully in place, financial institutions may only rely upon their own enhanced due diligence to ensure that no prospective depositor is stepping into one of the federal enforcement priority areas. Without specific reassurances from regulators regarding adequate policies, many financial institutions will not take the risk. The uncertainty surrounding the continuation of current federal policies is likely to have a chilling effect on financial institutions that may have otherwise been willing to accept cannabis-related accounts. Until the in-coming administration either accepts or repudiates current guidance neither canna-businesses nor financial institutions can be sure that they will not be subject to federal prosecution.

The marijuana industry faces several barriers to obtaining depository and related financial services: legal, social, and contractual. Ultimately, the underlying federal legal status of marijuana needs to change in order to fully ensure the industry has access to depository and related financial services. Even after changes at the federal level, there will remain a social perception or moral objection to marijuana that will prevent some boards from approving their institutions to serve the industry. Outreach, communication, and general support for financial institutions seeking to serve the industry may facilitate the provision of depository services, provided there is no change at the federal level. Increased familiarity with regulator expectations may act to assure financial institutions that regulators will not penalize them for accepting marijuana-related deposits. This will, in turn, inform other financial institutions' risk assessments and facilitate greater access to depository services. The realization of a full state administrative and enforcement scheme may also facilitate the provision of depository services to the industry. The full force of state controls will help institutions to more reliably determine that they are not implicating the federal enforcement priorities and will reduce on the costs of the required enhanced due diligence.

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I. BACKGROUND

As of October 2016, Oregon's burgeoning cannabis industry recorded $160 million in sales. The industry's growth, however, is hampered by the lack of access to banking and depository services. The department is aware of only 2 banks (10% of the state chartered banks) and 1 credit union (approximately 5% of state credit unions) that are knowingly accepting cannabis related accounts. This is comparable to Washington, which reports that approximately 5-10% of their state chartered financial institution are providing services to the industry.[1] Because legal canna-businesses are having trouble obtaining, or maintaining, a banking relationship, most operate on a largely cash basis. This creates difficulties related to paying employees and vendors. It affects recordkeeping and financial transparency. It creates logistical problems in paying taxes and licensing fees, exposing legal businesses, and their employees, to potential violent crimes related to large amounts of cash stored on the premises or manually transported. The lack of banking services also impacts the effectiveness of the state's regulatory regime. Lack of transparent financial dealings undermines the state's ability to safeguard against drug trafficking, black market dealings, and diversion of cannabis outside the regulated system. The cash-heavy economy not only affects direct participants in the cannabis market but also indirect participants. Agencies collecting licensing fees and tax revenues bring in large amounts of cash and are running into difficulties depositing it with their traditional banking partners.

The landscape around legal cannabis is constantly changing as more states legalize marijuana for recreational and medical purposes, the federal government takes policy stands, and as the market and regulations mature.[2] Ultimately, cannabis' status under federal law is the major impediment to "banking" the industry.[3] Only U.S. congressional action can "fix" the problem. However, the modest success Washington and Colorado have had banking their marijuana-related businesses points to actions at a state level that may encourage more financial institutions to offer depository services to the cannabis industry. Those states have had mature regulatory structures for licensing and tracking cannabis production and sales for at least a year. Washington and Colorado regulators engaged in extensive outreach to financial institutions, building relationships and providing specific guidance regarding institutional responsibilities for reporting and managing cannabis-related accounts. While Oregon's regulatory scheme is still coming fully on-line, Oregon's cannabis industry may benefit from state regulators following Washington and Colorado's lead regarding coordinated outreach to the financial institutions.

This report was drafted to meet House Bill 4094's mandate to the Department of Consumer and Business Services to study and identify actions to facilitate the provision of depository and related services to businesses that engage in the production, processing or sale of cannabis and

[1] It should be noted that Washington has more state-chartered financial institutions than Oregon.
[2] As of November 9, 2016, 28 states and the District of Columbia have decriminalized marijuana for medical purposes. Nine states have decriminalized marijuana for adult recreational use. The recent election may signal a change in policy at the executive level. The impact of changes at the U.S. Departments of Justice and Treasury are discussed later in this report.
[3] This report uses the term "banking" generically to refer to depository services offered by both banks and credit unions.

cannabis derived products.[4] HB 4094 was one of a series of bills enacted as part of the continuing refinement of Oregon's recreational cannabis market. The bill addressed three areas of cannabis financial regulation. First, it exempted financial institutions providing services to the legal cannabis industry from Oregon's money laundering statutes. Second, it required the Oregon Liquor Control Commission, the Oregon Health Authority and the Oregon Department of Revenue to share licensing applications and related documents with financial institutions. Finally, it required the Department of Consumer and Business Services to conduct a study on:

- The provision of depository and related financial services to businesses that engage in the lawful production, processing or sale of marijuana and marijuana derived products;
- State laws and rules, federal laws and regulations and administrative acts related to providing depository and related financial services; and
- How those laws, rules, regulations and acts apply to businesses that engage in the production, processing or sale of marijuana and marijuana derived products.

The department was specifically required to:

- Evaluate the Department of the Treasury's February 14, 2014, memorandum *BSA Expectations Regarding Marijuana-Related Businesses*; and
- Identify any legislation or administrative action required to facilitate the provision of depository and related financial services to businesses that engage in the production, processing or sale of marijuana and marijuana derived products.

The bill also required the department to present a report to the interim legislative committees related to business and any interim legislative committee specifically related to businesses that engage in the production, processing, or sale of cannabis and cannabis derived products. This report is structured in three parts: The issues facing financial institutions that accept cannabis related deposits; actions taken and recommendations that may spur greater access to depository services; and appendices that provide greater detail related to the regulation of financial institutions.

II. THE WORKGROUP

The Department of Consumer and Business Services convened a workgroup of agencies, financial services representatives, and interested persons to provide feedback on the content and format of this report. The workgroup met twice to discuss the regulatory and business landscape surrounding canna-business depository accounts and related services. Each of the workgroup members related issues that they encountered and brainstormed possible solutions. Representatives from the Oregon Liquor Control Commission and the Oregon Health Authority discussed the transition from the early sales of recreational marijuana to a full licensing and tracking program. They discussed progress toward HB 4094's requirement that they, along with the Oregon Department of Revenue, share information regarding licensure and compliance with financial institutions. Representatives from the Oregon Bankers Association and the NW Credit Union Association discussed the situation for local banks and credit unions. MAPS Credit Union shared their experiences opening and maintaining cannabis accounts, including compliance costs.

[4] Oregon Laws 2016, chapter 97 §7(1).

A representative from Umpqua Bank shared her perspective as well. Compliance Specialists and independent consultants discussed their experiences with financial institutions exploring cannabis accounts. A representative from an Oregon and Washington licensed money transmitter specializing in cannabis accounts shared his experiences. Representatives from the Oregon Treasury Department and Department of Revenue discussed depositing tax and licensing revenue.

A member of the Oregon Legislative Revenue Office joined the group, as well as representatives from Senator Merkley and Representative Read's offices. Lobbyists for Oregon's Consumer Finance industry also attended the meetings.

The group discussed the current state of "banking" the cannabis industry. They reviewed various proposals for improving access to depository accounts. The group discussed the Financial Crimes Enforcement Network's (FinCEN) guidance related to the Bank Secrecy Act (BSA)[5] responsibilities for depositories accepting cannabis accounts and the impact of the Cole memos.[6]

The workgroup considered the impact of regulatory actions in Washington and Colorado on canna-banking in those states. It discussed whether rescheduling cannabis would improve access to financial services and whether the formation of a state bank would provide a route for banking canna-businesses. The group reviewed the recent *Fourth Corner Credit Union* case which revolved around a Colorado-approved credit union unable to obtain a master account from the Federal Reserve.[7] The case illustrates the role master accounts play in the modern banking system. The group discussed actions that Oregon regulators could take that might encourage more depository institutions to look into accepting cannabis accounts.

The group debated actions at the state level that might alleviate some of the pressures related to canna-businesses as a cash heavy industry. Overall, the group believes that only action at the federal level will provide a final resolution to the issue regarding marijuana related accounts.

III. THE ISSUE

The root cause of the difficulty "banking" the cannabis industry is federal law. In particular, three federal laws working together impact financial institutions' ability to provide depository services to canna-businesses: the Controlled Substances Act (CSA);[8] the Currency and Foreign Transaction Reporting Act, commonly referred to as the Bank Secrecy Act (BSA);[9] and the Money Laundering Control Act.[10] While federal drug laws do not necessarily preempt state marijuana regulation efforts,[11] federal banking laws and regulations affect every financial institution: banks, credit unions, and money services businesses like money transmitters. The U.S. has a "dual" banking system where financial institutions are overseen by both state and federal regulators.[12] Financial institutions are legally obligated to protect the financial system

[5] The Department of the Treasury, Financial Crimes Enforcement Network, FIN-2014-G001, *BSA Expectations Regarding Marijuana Related Businesses* (February 14, 2014).
[6] Deputy Attorney General James Cole, *Guidance Regarding Marijuana Enforcement* (August 29, 2013). Deputy Attorney General James Cole, *Guidance Regarding Marijuana related Financial Crimes* (February 14, 2014).
[7] *Fourth Corner Credit Union* v. *Federal Reserve Bank of Kansas City*, 154 F.Supp.3d 1185, 1188 (US Dist.Colorado 2016).
[8] 21 U.S.C.§812 et seq.
[9] 31 U.S.C.§5311–5324, and the BSA regulations, 31 C.F.R. Part 103.
[10] 18 U.S.C. § 1956 & 18 U.S.C. § 1957.
[11] 21 U.S.C. § 903 (limits the scope of the CSA preemption of state laws to those that create a "positive conflict.")
[12] Please see Appendix A for more details regarding state and federal regulators.

from misuse by criminal money laundering. The fact that cannabis remains illegal at the federal level forces financial institutions to decide whether to violate federal law in order to help a state's cannabis industry or to close cannabis-related accounts and adhere to federal law.

While cannabis remains illegal under federal law, decriminalization by the states have resulted in policy statements from the U.S. Department of Justice and the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) related to prosecution of marijuana related crimes within states that have legalized cannabis. The "Cole memos" represent current prosecutorial priorities and the *BSA Expectations Regarding Marijuana Related Businesses* guidance lays out a financial institution's responsibilities if they hold canna-business accounts. Both documents expressly state that they do not change federal law regarding marijuana. Guidance documents can be withdrawn at will. The recent election, and announcements regarding the incoming administration's picks for heads of the Justice and Treasury Departments have left the fate of the current guidance very uncertain.

IV. CANNABIS RELATED GUIDANCE

The U.S. Department of Justice traditionally relies upon state and local officials to enforce narcotics laws.[13] Shortly after states began to decriminalize medical cannabis, the Department of Justice's Attorney General's office issued the first in a series of guidance documents to the U.S. Attorneys regarding investigations and prosecutions related to medical marijuana in states that had enacted laws allowing for cannabis cultivation and use.[14] In general, the memoranda from the U.S. Deputy Attorneys General have emphasized that marijuana remains illegal under federal law. Despite the federal status of cannabis, the memoranda admonish U.S. Attorneys to concentrate finite federal resources on the Department of Justice's core enforcement priorities.

The federal enforcement priorities laid out in 2009 have changed little. In short, they are:

- Keeping marijuana out of the hands of minors;
- Preventing diversion of marijuana from states where it is legal to other states where it is not;
- Preventing state authorized marijuana activity from being used as a pretext to traffic other drugs;
- Preventing criminal enterprises from profiting from the sale of marijuana;
- Preventing violent crimes and firearm usage;
- Preventing drugged driving and other adverse public health consequences; and
- Preventing growing, use, possession and production of marijuana on federal lands.[15]

Legalization of recreational cannabis in Colorado and Washington prompted the Department of Justice's Attorney General's office to look at recreational marijuana in 2013. The office determined that the CSA does not expressly preempt states from adopting their own drug laws, but the U.S. Attorney General could challenge individual state's regulatory schemes in order to

[13] 2013 Cole memo supra at 2.
[14] U.S Deputy Attorney General David Ogden, *Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana* (October 19, 2009).
[15] *Id at 2.*

address federally prohibited conduct.[16] Recently, former Deputy Attorney General James Cole described his 2013 memo as a common sense approach to address the office's priorities. He stated it was his intent to admonish states to "get serious about your regulatory enforcement" if they intended to decriminalize cannabis.[17]

In particular, Cole wrote, that the 2013 guidance was founded on the expectation that states and local governments implement strong and effective regulatory and enforcement systems to address threats that state laws allowing cultivating, processing, and distributing cannabis could pose to public health and safety. "A system adequate to that task must not only contain robust controls and procedures on paper; it must also be effective in practice."[18] If states' enforcement is "sufficiently robust" to protect against the harms represented by the federal enforcement priorities, then a federal prosecutor should rely on state and local law enforcement to address marijuana related activity.

> "If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms."[19]

Cole noted that "a tightly regulated market where revenues were tracked and accounted for" could "affirmatively address" the federal enforcement priorities.[20] Missing from the guidance was a clear path for financial institutions to provide services to canna-businesses in the context of federal laws which forbid engaging in financial and monetary transactions with proceeds from illegal activities. The guidance expressly stated that "neither the guidance herein nor any state or local law provides a legal defense to a violation of federal law, including any civil or criminal violation of the CSA."[21]

2014 saw significant changes in the cannabis field but no tangible changes in federal law. Responding to requests from Washington, Colorado, Oregon, and Alaska, Deputy Attorney General Cole issued guidance addressing marijuana related financial crimes. The question, specifically, was the treatment of financial institutions and marijuana related accounts. Cole responded to requests for clarification by stating that,

> "Financial transactions involving proceeds generated by marijuana-conduct can form the basis for prosecution under the money laundering statutes (18 U.S.C. §§ 1956 and 1957), the unlicensed money transmitter statute (18 U.S.C. § 1960), and the BSA."[22]

Cole reiterated, however, that it "may not" be an efficient use of federal resources to prosecute marijuana related activities that were conducted in accordance with a "clear and robust

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[16] *The Famous Marijuana Memos: Q&A with Former DOJ Deputy Attorney General James Cole* (July 27, 2016). http://mjbizdaily.com/the-famous-marijuana-memos-qa-with-former-doj-deputy-attorney-general-james-cole/
[17] Id.
[18] 2013 Cole memo supra at 2.
[19] Id at 3.
[20] Id.
[21] Id.at 4.
[22] 2014 Cole memo supra at 2.

regulatory scheme" established by a state, if the activity did not implicate an enforcement priority.[23]

The 2014 Cole memo was released in tandem with the FinCEN guidance paper, *BSA Expectations Regarding Marijuana Related Businesses*. The BSA is the primary tool for enforcing U.S. anti-money laundering laws. It requires financial institutions to report large cash deposits or withdrawals and suspicious activities that may indicate illicit activity. The Treasury Department's Financial Crimes Enforcement Network (FinCEN), the designated financial intelligence unit of the United States, establishes BSA related reporting requirements. FinCEN's guidance had the express goal of "enhancing the availability of financial services for canna-businesses with the accompanying financial transparency."[24] In an interview, James Cole expressed that the cash nature of marijuana-related business breeds "armed conflict" either as a means to steal cash or protect it. "That's why both FinCEN and I issued memos together saying, 'Banks, go ahead and do this, we want the banking to go forward.'"[25] However, in keeping with general depository law FinCEN left financial institutions to ponder the risks involved:

> "The decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution. These factors may include its particular business objectives, an evaluation of the risks associated with offering a particular product or service, and its capacity to manage those risks effectively. Thorough customer due diligence is a critical aspect of making this assessment."[26]

The FinCEN guidance specifically states a financial institution's anti-money laundering obligations under the BSA to file Suspicious Activity Reports (SARs) are "unaffected by any state law" legalizing marijuana related activities.[27]

> "Because federal law prohibits the distribution and sale of marijuana, financial transactions involving a marijuana-related business would generally involve funds derived from illegal activity. Therefore, a financial institution is required to file a SAR on activity involving a marijuana-related business (including those duly licensed under state law), in accordance with this guidance and FinCEN's suspicious activity reporting requirements and related thresholds."[28]

FinCEN's guidance points to the need for financial institutions to have policies and procedures in place to monitor non-compliance with state law and determine whether a business is implicating one of the enforcement priorities. FinCEN's guidance calls for enhanced due diligence by financial institutions and procedures in place to spot and report red flags. Compliance with FinCEN's guidance is complicated by the fact that canna-businesses, in an attempt to obtain depository services, often attempt to disguise their involvement with the industry. FinCEN considers this a "red flag" for financial institutions.

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[23] Id at 3.
[24] BSA Expectations supra at 1.
[25] Q&A With Former DOJ Deputy Attorney General James Cole supra. http://mjbizdaily.com/the-famous-marijuana-memos-qa-with-former-doj-deputy-attorney-general-james-cole/
[26] BSA Expectations supra at 2.
[27] Id at 3.
[28] Id.

Other "red flags" include accounts which have:

- More revenue than expected or reasonable given demographics or competition;
- Excessive cash deposits or withdrawals;
- Inconsistent financial statements; or
- Undisclosed parties of interest. [29]

Financial institutions that know their customers are involved in the industry must have policies and procedures in place to adhere to their BSA reporting requirements. Developing appropriate procedures, acquiring and training adequate staff, and continually monitoring cannabis-accounts is considered by some to be too expensive. Those financial institutions serving canna-businesses are charging relatively high account fees in order to cover associated costs. Because it is still a new field pricing accounts adequate to the risk can be difficult. Risk assessments must be made. The financial institution's board must understand and accept the risks. Often after an assessment of the risk and cost it is easier to simply close the accounts.

Under the FinCEN guidance, customer due diligence – colloquially "know your customer" – procedures and risk assessment should include:

- Verifying whether the business is duly licensed and registered and reviewing the application and related documentation;
- Requesting from state licensing and enforcement authorities available information about the business and related parties;
- Developing an understanding of the normal and expected activity for the business, including the types of products to be sold and whether customers are medical or recreational;
- Ongoing monitoring of publicly available sources for adverse information about the business and related parties;
- Ongoing monitoring for suspicious activity, including for any of the red flags described in the guidance; and
- Continually updating information "commensurate with the risk.[30]

The guidance outlined a financial institution's responsibilities for filing SARs on marijuana-related activities. FinCEN noted the BSA's purpose is to require financial institutions to file reports that are "highly useful in criminal investigations and proceedings."[31] FinCEN sought to assist financial institutions in determining how to file SARs that would facilitate law enforcement in collecting information related to delineated enforcement priorities. The guidance is specific to activity directly tied to the sales of marijuana; it does not address whether activities related to the secondary market (such as professional services, or equipment sales) should be accompanied by a SAR. Some members of the workgroup felt that lack of clarity regarding SAR requirements was an impediment to serving the cannabis industry.

In addition to the guidance provided by the U.S. Justice and Treasury Departments, the Federal Deposit Insurance Corporation (FDIC), which provides banks with required deposit insurance,

[29] Id. at 5.
[30] Id at 2-3.
[31] Id at 3.

issued a statement regarding providing banking services to businesses.[32] While the statement is not specific to canna-business accounts, the FDIC encouraged banks to serve their communities because of the importance of the services they provide. It encouraged banks to take a risk-based approach in assessing individual customers rather than declining to provide services to an entire business category. The FDIC letter tried to assuage bank's fears through an explicit recognition that it is not, as a practical matter, possible to detect and report all potential illicit transactions. The FDIC noted that isolated or technical violations within an otherwise "adequate system of policies, procedures, and processes, generally do not prompt serious regulatory concern."[33] As an examining and insuring entity, the National Credit Union Administration's (NCUA) policy is to follow the FinCEN guidance.[34]

The Cole memos and Treasury Department guidance, do not, and cannot, change federal law. The 2014 Cole memo expressly reserves the option to investigate and prosecute activity "even in the absence of any" of the enforcement priorities where "prosecution otherwise serves an important federal interest."[35] The various pieces of guidance, statements, and memoranda generally state that financial institutions can provide services to canna-businesses and encourage institutions to do so as a means of increasing financial transparency. However, in order to do so, financial institutions must make the explicit decision to violate federal law with no guarantees that they will not face administrative or criminal sanctions from federal authorities.

V. CURRENT AND RECENT ACTIONS TO FACILITATE DEPOSITORY SERVICES

Federal and state congressional delegations and regulators have taken actions to facilitate the provision of depository services to canna-businesses. The various guidance documents discussed above have focused law enforcement efforts toward smuggling and racketeering and criminal enterprises. Financial regulators have incorporated the Cole memo and FinCEN guidance into their examination procedures. The FDIC, DEA, and Oregon State Police all recently expressed that they were focused on criminal organization's money laundering, not simple transactions involving canna-businesses compliant with state law.[36] The DEA and Oregon State Patrol have shifted their focus to interstate traffic, smuggling and racketeering in keeping with the express federal enforcement priorities. While banking marijuana-related activity remains federally illegal, law enforcement is not pursuing financial institutions unless there is evidence of trafficking or money laundering for criminal enterprises.

At the federal level, in 2014, two U.S. Representatives from California succeeded in introducing an amendment to the federal spending bill. The Medical Marijuana Protection Amendment prohibited the U.S. Department of Justice from using federal money to pursue state-legal medical marijuana programs.[37] The provisions were updated in 2015 through the Farr-Rohrabacher

[32] Federal Deposit Insurance Corporation, FIL-5-2015, *Financial Institution Letter* (January 28, 2015).
[33] Id.
[34] Letter from Larry Fazio, Director of Examinations and Insurance NCUA to Scott Jarvis, Director, Washington State Department of Financial Institutions. July 18, 2014.
[35] 2014 Cole memo supra at 3.
[36] 2016 SAR Review Regulatory Panel (May 19, 2016).
[37] H R 4660 amendment 25 (2014). See also Matt Ferner, *Congress Passes Historic Medical Marijuana Protections In Spending Bill* Huffington Post (December 14, 2014).

Amendment to the federal spending bill.[38] Like the Justice Department memos and FinCEN guidance, the amendments to the spending bills did not change cannabis' status under federal law. The amendment to the 2015 spending bill was slated to expire at the end of 2016 but was extended to April 2017. However, it does not provide long term assurances to financial institutions that the Justice Department, under the incoming administration, will not reestablish a policy of pursuing cannabis related activities in states that have decriminalized it.

Two bills have been introduced to specifically address the issue of providing financial services to the marijuana industry.[39] The proposed Merkley-Wyden "Access to Banking Act" would prevent regulators from taking action against a financial institution if they are complying with FinCEN's guidance.[40] Likewise Representative Ed Perlmutter's Marijuana Businesses Access to Banking Act would provide a safe harbor for financial institutions by prohibiting federal regulators from terminating deposit insurance or otherwise discouraging financial institutions from providing services.[41] House and Senate leadership have not scheduled either bill for debate in their respective chambers.

At the 2016 National Conference of State Legislatures annual summit, Oregon Senators Ted Ferrioli and Ginny Burdick, along with Representative Ann Linninger, worked to draft and pass a resolution calling upon the U.S. Congress to give cannabis-related businesses the access to the banking system that other legal businesses enjoy. Those same Oregon senators and Representative sponsored, with others, Oregon Senate Joint Memorial 124 in 2015 calling upon the U.S. Congress to de-schedule cannabis.[42]

At the state level, the Oregon Legislative Assembly established the framework for a regulatory system that affirmatively addresses the federal enforcement priorities. The framework established by statute requires licensing and tracking as part of Oregon's robust regulatory scheme. The regulatory structure established by the legislature will help affirmatively address the federal enforcement priorities upon full implementation. This is particularly important to a financial institution's policies and procedures related to following the FinCEN guidance.

Washington and Colorado report that their marijuana regulatory programs provide a level of confidence to financial institutions that businesses are not implicating the federal enforcement priorities. They established systems to share licensing and enforcement information with financial institutions. Oregon's recreational regulatory system is still coming fully on-line. HB 4094 mandated the sharing of licensing and enforcement information with financial institutions. FinCEN has stated financial institutions can rely upon this information as a part of their due diligence regarding account holders. The OLCC is in the process of developing a process to share information with financial institutions.

Oregon financial institutions that currently provide depository services to canna-businesses report that BSA compliance is expensive and time consuming. While compliance software

[38] Medical Marijuana Protection Amendment, S2837 §537, 114th Congress (2015).
[39] 2015 saw a number of other marijuana related bills introduced though none have been referred to the floor. Representative Jared Polis from Colorado introduced H.R.1013 - Regulate Marijuana Like Alcohol Act which was introduced in the House in February 2015. Senator Bernie Sanders introduced S. 2237: Ending Federal Marijuana Prohibition Act of 2015 in November of 2015. Representative Susan Beldene from Washington introduced H.R. 3746: State Marihuana And Regulatory Tolerance Enforcement Act. These are in addition to bills introduced specific to medical marijuana.
[40] Access to Banking Act, S1726, 114th Congress (2015).
[41] Marijuana Businesses Access to Banking Act, HR 2076, 114th Congress (2015).
[42] Oregon Senate Joint Memorial 12, 78th Legislative Assembly (2015).

programs are available, they vary in terms of capability. The institutions concerned with "doing it right" face significant capital outlays to purchase rigorous compliance software and increase staffing levels and training. Comprehensive research, including site inspections, needed to meet enhanced, and continuing, due diligence obligations are expensive and usually outside the areas of a financial institution's expertise. Cannabis accounts result in increased workload for BSA reporting.

Because of the relative newness of recreational cannabis markets, there is a lack of knowledgeable staff. Financial institutions currently lack data on "normal transaction volume," which is necessary to determine if marijuana related businesses are engaged only in legal sales. Once licensing, tracking, and information sharing processes are fully established the state may see an increase in the number of canna-businesses that are able to open and maintain depository accounts. Any of the pieces of proposed federal legislation could provide an impetus for additional financial institutions to enter the field. However, without a change of heart by federal congressional leadership, the bills may never be scheduled for a floor session and vote.

VI. CHANGES TO STATE OR FEDERAL LAW AND REGULATIONS TO FACILITATE DEPOSITORY SERVICES

The workgroup unanimously agreed that the current treatment of marijuana under federal law was the primary impediment to banking the industry. There was agreement that the only absolute way to guarantee that depository services are available to the nascent industry is de-scheduling cannabis at the federal level. As long as it remains federally prohibited, accepting deposits derived from the cultivation or sale of cannabis will technically be money laundering. Banks and credit unions serving the industry could be subject to confiscation and forfeiture of marijuana related deposits, and could face fines, loss of their charter, or loss of deposit insurance. Providing depository or other financial products to businesses engaged in producing, processing, or selling marijuana violates federal anti-money laundering laws - an inherently risky and unsafe practice.[43] Financial institutions also worry about losing their master accounts through the Federal Reserve. Without access to a master account, a financial institution cannot participate in the electronic payments network, which facilitates same day settlement of accounts across the country. For a full discussion, please see the discussion of Fourth Corner Credit Union within the discussion of a state or dedicated financial institution.

Lobbying:

Members of the workgroup expressed that Oregon's congressional delegation, the Governor, and other governmental groups may be able to join with other states with legal cannabis to actively advocate for changes to the Controlled Substances Act (CSA). If the delegations of the 28 states with legal cannabis combined their voices it might have a greater impact than Oregon's delegation alone. Considering California, Nevada, and Massachusetts' recent adoption of recreation cannabis, a solid majority of states will likely need to address the state of banking

[43] In addition to administrative enforcement and civil and criminal penalties under the BSA, financial institutions are also subject to RICO claims. The Racketeer Influenced and Corrupt Organization Act (18 U.S.C. §§ 1961-1968) extends liability and criminal penalties to persons assisting with an ongoing criminal activity. Under the Money Laundering Control Act, it is a federal crime to "knowingly engaging in a financial transaction with the proceeds of a crime for the purpose of concealing or disguising the illicit origin of the property from governments." (18 U.S.C. §§1956-1957).

canna-businesses. Together those states may be able to influence the chair of the various committees to bring the bills that have been introduced to the floor for a vote. This optimism is supported by Representative Earl Blumenauer. As part of the Oregonian's Big Idea series, Representative Earl Blumenauer discussed momentum at the federal level regarding cannabis. Prior to the 2016 election, he noted that the federal "banking" bills have bi-partisan support. He asserted he felt the federal government was close to taking action.[44] "These two provisions are teed up, and we will see action within the next two years to stop this discrimination against state-legal marijuana businesses. I think it will be supported on a bipartisan basis."[45]

Representatives of the financial industry are working with Oregon's congressional delegation to send the message that the institutions do not think they can serve canna-businesses at this time. The workgroup believes that coordinated advocacy on the issue could ultimately lead to action at the federal level. While speculation exists that the Congress will not take action until 30 states have decriminalized the drug, a coordinated effort by the combined states' congressional delegations could prompt action.[46]

California Representative Dana Rohrabacher and Oregon Representative Blumenauer recently announced the creation of a caucus to improve the odds to passing federal marijuana reform bills. "There needs to be more strategy between us, those of us who are engaged in this. More of a long-term strategy."[47] This type of coordinated effort will be necessary in light of the fact that the Congressional leadership that has thus far kept marijuana reform bills from votes on their respective floors are unlikely to change.

The workgroup discussed the results of the 2016 election that resulted in California, Massachusetts, Nevada, and Maine joining the ranks of states that have legalized recreational marijuana. With nine states legalizing recreation cannabis, the push at the federal level could result in the passage of one or more of the bills currently introduced. California recently became the sixth largest economy in the world. Reports have estimated that eventually the California market could be worth upwards of $6 billion.[48] While it is far from certain, the group generally agreed that California's passage of recreational cannabis could put significant pressure on the federal government to address the issue of banking the industry. In addition, Florida's initiative for medical marijuana use has it poised to become the second largest cannabis market in the country. The proposed cannabis caucus is hoping to reach across party lines with the message that both Republican and Democrat constituents are increasingly in favor of legalizing marijuana for at least medical purposes.[49]

The guidance provided up to this point is based on the policies of the current and immediately past administrations. The president-elect has not committed to continuing the current policy. The president elect has stated that he supports medical marijuana but it remains unclear if he fully

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[44] The Oregonian presents: The Big Idea: Cannabis, at Revolution Hall, Portland Oregon (October 24, 2016).
[45] Staff reporter, *President Trump: Election Surprise Creates Huge Uncertainties for Cannabis Industry*, Marijuana Business Daily (November 9, 2016).
[46] Don Childears, President and CEO Colorado Bankers Association, *Banking and Marijuana: Colorado's Perspective*, Conference of State Legislatures, Banking Services for Marijuana-Related Businesses Session (August 8, 2016).
[47] Miranda Green, *Congressmen to Launch Cannabis Caucus in 2017: it's a joint political effort to pass marijuana reform*, Decode DC (December 9, 2016). http://www.decodedc.com/congressmen-launch-cannabis-caucus-2017
[48] Geoffrey Mohan, *What would a recreational marijuana market in California look like?* LA Times (November 10, 2016). http://www.latimes.com/business/la-fi-marijuana-market-20161110-story.html.Accessed December 1, 2016.
[49] *Cannabis Caucus* supra.

supports the right of the individual states to determine marijuana policy. However, his nominee for Attorney General, Senator Jeff Sessions, has been outspoken about his opposition to cannabis. He stated at a hearing in April 2016, that "marijuana is not the kind of thing that ought to be legalized, it ought not to be minimized, that it's in fact a very real danger."[50] If the president-elect does not direct the Department of Justice to continue the policy of focusing only on the Ogden/Cole enforcement priorities, the guidance could be withdrawn leading to a full-scale divestment of cannabis-related accounts by financial institutions. Steven Mnuchin, the president-elect's pick for Treasury Secretary, has no public administration background and no known on-record statements regarding cannabis; his position on the issue is unknown. Until the president-elect and his new cabinet members take office the uncertainty may have a chilling effect on the ability of canna-businesses to obtain or maintain depository accounts. No financial institution is going to make the investment required to comply with the BSA only to be told at either the state or federal level that they cannot serve canna-businesses after all.

Due to the stigma of marijuana, even full legalization at the federal level will not result in a universal acceptance of cannabis-related accounts. There remains a reputational risk due to marijuana's social stigma. Full legalization aside, some boards may always steer away from including cannabis accounts in their business model.

Rescheduling:

The workgroup discussed whether rescheduling marijuana from a Schedule I narcotic to a Schedule II would impact banking. The CSA gives scheduling authority to the U.S. Attorney General and the Department of Health and Human Services (DHHS). For the purpose of the Controlled Substances Act, the Attorney General delegates its power to the Drug Enforcement Agency (DEA), and the DHHS delegates its power to the FDA. Amidst a growing interest among the states in medical marijuana, the DEA looked into rescheduling marijuana to Schedule II. Ultimately, it declined to reschedule citing to a lack of available research on medical uses. The agency did expand the approved suppliers beyond the University of Mississippi, previously the only approved federal supplier of marijuana for research purposes. However, only universities may apply for federal approval to study marijuana. Few universities have gone through the process and expense to be able to study marijuana. As of October 2016, the DEA had not received any permit applications to research or grow marijuana for research.

The workgroup felt that rescheduling would not significantly impact the ability of financial institutions to provide services to the marijuana industry. Schedule II drugs are still highly regulated. They are only legal in the presence of a doctor's prescription. Rescheduling would not impact the ability of businesses to legally deposit revenue from recreational sales which do not require a doctor's prescription.

Regulatory Actions:

In the absence of federal action, the workgroup opined that more clarity from federal and state regulators is needed to encourage financial institutions to serve the industry. The financial industry representatives reported that state regulator feedback has been constructive. They

[50] Senate Caucus on International Narcotics Control, "Is the Department of Justice Adequately Protecting the Public from the Impact of State Recreational Marijuana Legalization?" (Tuesday, April 5, at 10:00 a.m) accessed at http://www.drugcaucus.senate.gov/content/department-justice-adequately-protecting-public-impact-state-recreational-marijuana

appreciated regulators assisting financial institutions to understand and adhere to their compliance obligations. The workgroup believes what is really needed is specific guidance that will define what cannabis policies look like.

At least some in the workgroup expressed that state regulators will need to actively support serving the industry. Where examiners express disproval of a particular business strategy such as serving high risk industries, the less likely financial institutions are to enter or continue with that strategy. This point is illustrated by Operation Chokepoint when FinCEN began a crackdown on money service businesses and alternative lenders. The idea behind the operation was to cut off the target industries' access to depository and electronic transfer services. In response the target industries, even when there was no indication of wrongdoing, found that bank partners were much harder to find as financial institutions determined that the risk of doing business with the target industries was too high.

Washington and Colorado report relative success in banking their canna-businesses, though it is unclear how many canna-businesses in each state are officially banked. Additionally, it appears as though only a relatively small number of financial institutions in those states are knowingly accepting deposits from canna-businesses. Institutions serving canna-businesses must maintain enough liquidity to cover the amounts received on deposit. The author interviewed Washington and Colorado state regulators wherein they expressed that they performed active outreach to financial institutions, providing specific guidance to encourage institutions to serve the industry. Regulators from those states also indicated that as institutions serving the industry successfully went through the examination process more institutions made the decision to serve marijuana related depositors.

Part of Washington and Colorado's success is attributable to the existence of fully operational marijuana regulatory programs. By comparison with Oregon, Washington had licensing and tracking systems in place before allowing the growers to even plant. Financial institutions report that they need traceability for a level of comfort that revenue is from legal sales. Most of the workgroup members shared the opinion that access to OLCC's and OHA's licensing and compliance information will contribute to the financial industry's ability to serve canna-businesses. Having access to licensing and compliance data allows for independent verification that account holders are complying with Oregon's laws and provide some comfort that account holders are not running afoul of Cole memo priorities. In the future, sharing licensing data may help reduce the costs associated with canna-business accounts. The workgroup was encouraged that OLCC's reputation may allow financial institutions to rely, to some extent, on OLCC inspections rather than solely upon their own site visits and related inspections. The workgroup speculated that there may be an improvement in the financial services environment once the licensing and tracking system are up and running.

While third-party compliance vendors are entering into the cannabis field, financial institutions cannot ignore or completely outsource BSA compliance. Regarding money service businesses, while they can provide an extra layer of BSA reporting and tout services that ensure canna-businesses are not implicating the federal enforcement priorities, they can also add a layer between the financial institution and ultimate deposit holder. Some institutions complain that this has the effect of doubling compliance requirements and "know your customer" efforts. An institution may lose the ability to identify customers when they are routed through a third party. In a situation where a money service business has a strong compliance program and a strong relationship with a financial institution, adherence to the FinCEN guidance may be enhanced.

Where regulators approve of such a relationship it could have the effect of reducing compliance costs while still ensuring that enforcement priorities are protected. This assumes that the enforcement guidance under the current administration does not change, which is still an open question.

A state or dedicated financial institution:

The workgroup also discussed the idea of a dedicated financial institution to serve the cannabis industry. The group determined that a state bank is unlikely to yield a workable answer to the immediate issue. The main obstacles to forming a state bank are strong prohibitions in the Oregon Constitution, access to federal deposit insurance, and a Federal Reserve master account, respectively.

The Oregon Constitution Article XI section 1 states:

> "the Legislative Assembly shall not have the power to establish, or incorporate any bank or banking company, or monied [sic] institution whatever; nor shall any bank company, or instition [sic] exist in the State, with the privilege of making, issuing, or putting in circulation, any bill, check, certificate, prommisory [sic] note, or other paper, or the paper of any bank company, or person, to circulate as money."

This has generally been read to preclude the establishment of a state bank in Oregon. Even if the Legislative Assembly was able to establish a bank under another reading of the constitution, chartering a new institution is a complicated process. As discussed in Appendix A to this report, financial institutions are heavily regulated. At least five persons with sufficient expertise to indicate to regulators that the financial institution will be successful are required to petition for incorporation of a bank.[51] A credit union requires at least 7 persons.[52]

In order to operate, the institution would be required to obtain deposit insurance. At this point it is unlikely that the FDIC would provide deposit insurance to a bank with a high concentration of cannabis-related accounts. The NCUA has declined to provide share insurance[53] to a credit union specifically chartered to serve canna-businesses. The Fourth Corner Credit Union case is illustrative of the types of challenges that financial institutions chartered to address the canna-banking issue have faced.

Colorado attempted to assist in the provision of depository services by granting Fourth Corner Credit Union a state charter to serve the interests of the legalized cannabis and hemp industries and their supporters. Colorado's marijuana policy coordinator Andrew Freedman stated that both he and Colorado's Governor thought it would be "a pretty good short-term solution to getting cash off the streets and bringing some measure of financial accountability to the marijuana industry."[54] Freedman noted that a number of banks felt that they were not able to serve the

[51] ORS 707.070 (2015).
[52] ORS 723.012 (2015).
[53] For credit unions deposit insurance is "share insurance."
[54] Joel Warner, *Marijuana Banking: The Fourth Corner Credit Union Fights In Court To Become The World's First Cannabis Bank*, IB Tech Newsletter (December 29, 2015). Accessed 12-5-16 http://www.ibtimes.com/marijuana-banking-fourth-corner-credit-union-fights-court-become-worlds-first-2241994.

industry. They felt that "the existence of a marijuana credit union would give more faith to other banks and credit unions that they are able to bank marijuana."[55]

However, the NCUA denied the application for share insurance due to the risks of the credit union's business model. Additionally, the Federal Reserve rejected the credit union's application for a master account which would allow the institution to conduct business. The master account is necessary to interact with other financial institutions and process electronic payments. Fourth Corner sued the NCUA and Federal Reserve Bank of Kansas City for equal access to the banking system. The suit alleged that since generally insurance and master accounts are granted as a matter of course that the NCUA and Federal Reserve Bank were denying it equal access to the payments system.

A federal judge dismissed the case in December 2015, stating that the guidance provided by the Cole memos and FinCEN did not have the effect of changing the law. The judge held that the court is unable to facilitate illegal activity.[56] He noted that without access to a master account "The Fourth Corner Credit Union is out of business."[57] The opinion summed up the effect of the guidance documents:

> "In short, these guidance documents simply suggest that prosecutors and bank regulators might "look the other way" if financial institutions don't mind violating the law. A federal court cannot look the other way. I regard the situation as untenable and hope that it will soon be addressed and resolved by Congress."[58]

The Fourth Corner decision illustrates the difficulties facing states with legal cannabis industries. Even where a state is able to take action to charter a financial institution and where alternative deposit insurance is an option, the federal prohibition effectively prohibits federal entities from facilitating cannabis-related accounts. Some financial institutions cite fear of losing access to their master accounts as a reason why they cannot accept cannabis-related deposits. While it is unlikely, in light of the current guidance, that a financial institution would be stripped of its master account simply for accepting cannabis accounts if it is following the federal guidance, it remains a risk factor. Additionally, there is no guarantee that the incoming administration will retain the guidance related to cannabis accounts.

VII. CONCLUSION

Discussions with Legislative Revenue Office staff indicate they would like to be able to see a more modern financial transaction system available to canna-businesses to facilitate taxation payments and contribute to transparency and financial enforcement. This view was unanimously shared by the workgroup. Facilitating financial transactions will lower the cost to the state in general, resulting in more actual revenue from cannabis for the state. Currently, a majority of financial institutions are declining to retain cannabis-related accounts due to the federal prohibition. A small number of institutions have determined they can manage the risk and have policies and procedures in place to manage cannabis-related accounts. The uncertainty of how

[55] Id.
[56] *Fourth Corner* supra at 1188.
[57] Id. at 1186.
[58] Id. at 1189.

the president-elect and his cabinet nominees will handle state legalized cannabis will likely have a chilling effect on new entrants to the field.

While some financial institutions are waiting for federal law to change before serving the industry, some financial institutions will never find it appropriate to serve the cannabis industry based on principle, risk tolerance levels, or for concerns over reputational harm. The remaining institutions are either currently serving the industry or are likely to begin serving the industry, even in the absence of federal law changes, if they feel that regulators will approve of their decision to do so. Likewise, while some canna-businesses have successfully worked with their financial institutions to open and maintain depository accounts, some will likely never be able to access the banking system. This could be the effect of prior association with black market cannabis, failure to share information that financial institutions require, or simply a failure to maintain adequate tracking and procedures related to the federal enforcement priorities.

In part, it may be that time is the only solution to resolve the numerous issues that have arisen out of the conflicts between state and federal laws and policies. Further, as canna-business continue to evolve and more states continue to decriminalize marijuana, there may be a trend towards greater industry and regulatory tolerance to canna-business accounts, provided there is no change in policy at the federal executive level. Until then, if Oregon can assuage the fears of even a small number of financial institutions it will be possible to provide a significant percentage of canna-businesses with access to depository accounts and the electronic payments system, facilitating the use of the ACH and relieving some pressure from the otherwise cash heavy economy.

Washington and Colorado credit their relative success with "banking" the industry largely to rigorous outreach to the institutions, including providing exam criteria. Prior to serving canna-businesses, financial institutions' boards will have to make difficult decisions. Currently, there is a perception that it is currently easier to say, "not right now because of the federal threat," than to invest time and resources into developing a compliance program subject to obsolescence if, or when, policies at the federal level are reversed. Regulator support may be able to tip the risk assessment of at least a small number of financial institutions in favor of providing services to canna-businesses. Washington and Colorado have been expressly approving of institutions serving the industry. Neither encouraging nor discouraging cannabis accounts is consistent with the reality that a financial institution must make risk assessments consistent with their business plan and with board approval. However, regulator neutrality may be inadequate for the purpose of assuaging institutions that serving the industry in general is acceptable. Oregon regulators should follow Washington and Colorado's lead in engaging in sincere dialogue with financial institutions about serving canna-businesses. While it will not encourage all or even a majority of financial institutions to handle canna-business accounts, it may encourage enough to meet the needs of most of the industry.

APPENDIX A
Regulation of Banks and Credit Unions

General

The regulation of financial institutions developed historically in response to various political events and financial crises. The key goals of regulation are protection of depositors, monetary stability, promoting confidence in the banking system, and maintaining adequate levels of banking services throughout the nation.[59] Financial institutions are prohibited from certain activities regulators consider too risky to the integrity of the financial system. Financial institutions must conduct an assessment of their customer base and product offerings, and determine the risks.[60] Institutions must maintain adequate capital relative to asset and operational risks. They must have enough low-risk and liquid securities to cover normal deposit fluctuations. Risk diversification is required by regulators to insulate banks from downturns in any one specific area.[61] Restrictions on bank risk taking were initially developed in order to limit bank failures, bank panics, and protect depositors. While the advent of deposit insurance helped to ensure deposits were protected, it also introduced the new concern of protecting the insurance fund's long term viability. Regulators try to balance bank risk-taking activities with normal banking functions necessary to a competitive financial system.

In general, national banks and federal credit unions are regulated under federal law. National banks must become member banks of the Federal Reserve. Nationally chartered banks are regulated by the federal Office of the Comptroller of Currency (OCC). The OCC conducts examinations of national banks, evaluating bank activities and management processes to ensure national banks operate in a safe and sound manner and are compliant with laws and regulations. National banks are required to insure deposits through the Federal Deposit Insurance Corporation (FDIC). Oregon has no authority to regulate federally chartered banks or credit unions.

Oregon requires state-chartered banks have deposit insurance through the Federal Deposit Insurance Corporation (FDIC).[62] State chartered credit unions must be insured through the National Credit Union Administration (NCUA), or an approved alternative.[63] Because of the requirement for deposit insurance, state-chartered institutions are supervised jointly by the state and the insuring federal entity (FDIC or the NCUA). Oregon has one Federal Reserve member bank which is subject to supervision by the Federal Reserve, instead of the FDIC, to avoid duplicative exams.

Oregon's Division of Financial Regulation of the Department of Consumer and Business Services charters and examines state banks. Exams of banks rated by regulators as satisfactory or better and with over $500 million in assets are conducted jointly by federal and state regulators on a yearly basis. Banks rated as satisfactory or better with under $500 million in assets have exams conducted every 18 months and the state and federal regulator rotate taking the lead on

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[59] Kenneth Spong, *Banking regulation, its Purposes, Implementation and Effects*, Division of Supervision and Risk Management, Federal Reserve Bank of Kansas City (2000).
[60] 31 CFR 103.121.
[61] Spong supra at 75.
[62] ORS 706.008(1) "Bank" means a company, other than an extranational institution, that accepts deposits that the Bank Insurance Fund insures to any extent under the provisions of the Federal Deposit Insurance Act, as amended, 12 U.S.C. 1811, et seq.
[63] ORS 723.582 (2015).

the examination. For credit unions rated as satisfactory or better with under $250 million in assets, the NCUA will accept state examination reports. For credit unions with higher assets, state and federal regulators conduct joint exams.

Both banks and credit unions are examined by their respective regulators to ensure that a written, board approved Bank Secrecy Act and Anti-Money Laundering program is in place.[64] The plan must be designed to assure and monitor compliance with federal law. This assurance includes proper internal controls, on-going compliance training, and a designated BSA officer.[65] Because of the dual regulatory system, the federal treatment of marijuana is a factor in financial institution examinations regardless of state law.

Money Service Businesses

Money services businesses are non-bank financial institutions. The federal government developed the term in 1999 when the Secretary of the Treasury revised regulatory definitions of certain non-bank financial institutions for purposes of the BSA. The term includes currency dealers and exchangers, check cashers, issuers, sellers, and redeemers of traveler's checks, money orders, pre-paid or stored value cards, and money transmitters.[66] Money transmission typically involves the electronic transfer of funds through a bank account. Typically, a consumer goes to a money transmitter to either directly transfer funds or to purchase a payment instrument like a pre-paid gift card. In either event, the money transmitter deposits the consumer funds in its account and then routes the funds to the final recipient through an electronic funds transfer. Money services businesses are subject to the same BSA reporting requirements as other financial institutions. Any institution that fails to report could be prosecuted for knowingly aiding and abetting a federal crime accepting deposits of money from narcotics related sales and distribution.

The Federal Reserve and Master Accounts

The Federal Reserve or "the Fed," is the central bank of the United States. The Federal Reserve System was created in 1913 after a series of small bank failures. Congress established it to provide the nation with a safer, more flexible, and more stable monetary and financial system. The Federal Reserve System is composed of a central, independent governmental agency (the Board of Governors) and 12 regional Federal Reserve Banks. Member banks are stockholders of their District Reserve Bank and are required to hold 3 percent of their capital as stock in their Reserve Bank. The Federal Reserve is responsible for conducting the nation's monetary policy, and influencing money and credit conditions. The 12 District Federal Reserve Banks are responsible for supervising and regulating member financial institutions for safety and soundness.

Federal Reserve Banks provide "master accounts" to depository institutions such as banks and credit unions. Institutions hold reserve balances in their master account. The master account is also used to make loans to depository institutions, move currency and coin into and out of circulation, and collect and process checks and other payments.

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[64] 12 CFR § 326.8 (2013).
[65] 12 CFR 21.11, 12 CFR 21.21, 12 CFR 163.180 & 12 CFR 748.1 (filing reports)(2013).
[66] 31 CFR103.11(uu).

The Reserve Banks play a central role in electronic funds transfers. Reserve Banks and the Electronic Payments Network (EPN) operate the national Automated Clearinghouse (ACH) system which allows for the movement of electronic payments between institutions. Reserve Banks receive files of ACH payments from originating depository institutions, edit and sort the payments, deliver the payments to receiving depository financial institutions, and settle the payments by crediting or debiting the depository institutions' settlement account. The Reserve Banks and EPN work together to process payments where the originating depository institution and the receiving institution are served by different operators. These types of payments are settled by the Reserve Banks.

The Reserve Banks collectively own and operate three types of automated funds transfer and settlement services that rely on access to master accounts. The two relevant to this report are:

- National Settlement Service which is used to exchange and settle transactions on a multilateral basis through designated master accounts held at the Reserve Banks; and
- Fedwire Funds Service, the world's largest high-speed electronic payment system, which is used by financial institutions and others with a master account to transfer funds for large-value, time-critical payments.

The Bank Secrecy Act of 1970

The Currency and Foreign Transactions Reporting Act is typically referred to as the Bank Secrecy Act (BSA). It is the primary tool for enforcing U.S. anti-money laundering laws. It contains reporting responsibilities including a requirement that financial institutions report large cash deposits or withdrawals and suspicious activities that may indicate illicit activity. BSA related reporting requirements are established by the Treasury Department's Financial Crimes Enforcement Network (FinCEN) as the designated financial intelligence unit of the United States. FinCEN is responsible for maintaining a government-wide data access service containing a range of financial transactions information, including suspicious activity reports (SARs) and currency transaction reports (CTRs) filed by financial institutions.[67] FinCEN analyzes and disseminates the information from the reports to federal, state, local, and international law enforcement in order to "safeguard the financial system from illicit use and combat money laundering and promote national security."

Multiple regulators examine for compliance with the Bank Secrecy Act (BSA). Federal regulators consider BSA compliance a safety and soundness issue because of the reputational, regulatory, legal, and financial risk to a financial institution involved in money laundering schemes or violating the BSA statute. Failure to comply with BSA requirements can result in civil penalties and regulatory enforcement actions which can adversely impact the bank's capital and earnings. Financial institutions' board members can be criminally prosecuted for willful violations of anti-money laundering statutes that could ultimately lead to an institution's deposit insurance being cancelled.

Administratively, the BSA requires each financial institution to "know its customers" to ensure the financial institution is not being used by criminal elements for money laundering activities. The U.S. P.A.T.R.I.O.T Act required the U.S. Treasury Department, acting through FinCEN, to develop regulations making customer identification policies mandatory for all financial

[67] 31 U.S.C. 310.

institutions.[68] Financial institutions must implement reasonable procedures to verify the identity of persons wanting to open an account; maintain records of the information used to verify the person's identity; and determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. The BSA specifically requires enhanced due diligence by financial institutions providing services to persons or businesses posing a greater risk of money laundering, such as casinos and other cash heavy sectors.

FinCEN developed a new classification of suspicious activity report for canna-businesses. Financial institutions should file a "Marijuana Limited Suspicious Activity Report" for activities in states that have legalized marijuana and where none of the Cole memo enforcement priorities are implicated. Marijuana Limited SARs require minimal information identifying the subject and related parties to a transaction, their addresses, that the SAR is only being filed because cannabis remains illegal under federal law, and that no additional suspicious activity has been identified.

Where financial institutions believe that activity implicates an enforcement priority, they must file a Marijuana Priority SAR. A Marijuana Priority SAR should cite the specific enforcement priorities that the activity implicates. The Marijuana Termination SAR is filed when a banking relationship has been terminated because of the suspicious activity. FinCEN requires each SAR have information in the heading and in the narrative to help law enforcement in its investigation of criminal activity. When a Marijuana Termination is filed financial institutions are encouraged – though not required – to notify other financial institutions under FinCEN's 314(b) voluntary information sharing program that they have terminated an account for cannabis activity that implicates one of the enforcement priorities. 314(b) provides a safe harbor for financial institutions for what would otherwise be an illegal activity. Generally, financial institutions are not allowed to discuss the existence of a SAR.

[68] 115 Stat. 272 (2001).

Appendix B
The Controlled Substances Act and Brief History of Department of Justice Actions Against state legal cannabis

An institution's risk assessment of cannabis accounts must take into consideration the federal status and treatment of cannabis. The Controlled Substances Act (CSA) was passed in order to execute the international Single Convention on Narcotic Drugs.[69] Under the CSA, the term "controlled substance" means "…a drug or other substance, or immediate precursor, included in schedule I, II, III, IV, or V of part B of this subchapter." The CSA specifically does not include "distilled spirits, wine, malt beverages, or tobacco."[70] Under the CSA, marijuana is a Schedule I drug. This means it has been determined to have a high potential for abuse and no currently accepted medical use. Regardless of a state's regulation of cannabis like alcohol or tobacco, marijuana is treated differently for purposes of federal law.[71]

The states began to implicitly challenge the CSA by decriminalizing marijuana as early as 1973, when Oregon decriminalized possession of small amounts of cannabis. California was the first state to decriminalize marijuana for medial purposes.[72] California's authority to legalize a Schedule I drug was tested in 2002, when Drug Enforcement Administration agents, along with the County Sheriff destroyed six plants belonging to a medical marijuana patient. Angel Raich, the medical marijuana patient, argued that the CSA was unconstitutional as applied to her because she was not engaged in the interstate commerce of cannabis. The marijuana in question was completely grown and consumed under California law. The U.S. Supreme Court disagreed. The Court ruled that any conduct surrounding marijuana necessarily implicated the illicit market.[73] The takeaway from the case is that cannabis cultivated, processed, or distributed in full compliance with state laws is indistinguishable from illicit cannabis. Persons and canna-businesses participating in the state's regulated market can be prosecuted by federal authorities for violation of the CSA.[74]

In the aftermath of the *Raich* case, the DEA conducted a series of raids on individuals and businesses involved in the medical cannabis market, seizing both marijuana and business assets. One result of this is that financial institutions are unlikely to lend money to canna-businesses because of the possibility of losing the collateral to civil forfeiture actions.

In 2009, U.S. Deputy Attorney General David Ogden issued guidance regarding the prosecution of medical marijuana patients. Ogden expressed the Department of Justice's continuing commitment to prosecution of marijuana related crimes in keeping with its status as a dangerous drug that provides significant revenue to "large scale criminal enterprises, gangs, and cartels."[75] It also enumerated core enforcement priorities on which federal prosecutors should focus. The Department of Justice wanted to guide "the exercise of investigative and prosecutorial discretion

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[69] The United States has signed on to international efforts to curb drug abuse and trafficking. The U.S. agreed to the terms of the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances in 1988, including Article 5 which requires states to confiscate proceeds from drug offenses. The Convention calls for empowering federal courts to order financial or commercial records be made available or seized.
[70] 21 U.S.C. § 802(6).
[71] This extends to the availability of tax credits for marijuana related businesses.
[72] Proposition 215, added the Compassionate Use Act of 1996 to California's Health and Safety Code.
[73] *Gonzales v. Raich*, 545 U.S. 1 (2005).
[74] Id.
[75] Ogden memo supra at 1.

toward "significant trafficking" and the disruption of illegal drug manufacturing networks."[76] Ogden suggested that federal prosecutors should not focus resources on individuals "in clear and unambiguous compliance with existing state laws."

> "For example, prosecution of individuals with cancer or other serious illnesses who use marijuana as part of a recommended treatment regimen consistent with applicable state law, or those caregivers in clear and unambiguous compliance with existing state law who provide such individuals with marijuana, is unlikely to be an efficient use of limited federal resources."[77]

The 2009 memo was intended to communicate that the prosecution of sick individuals and their caretakers should not be a focus of federal prosecutors. However, some have suggested that it also signaled that persons involved in the cannabis market but abiding by state law were fine.[78]

In 2011, responding to increased cannabis cultivation in states that had decriminalized it for medical purposes, U.S. Deputy Attorney General James Cole issued a follow-up memo specifically stating state and local laws are not a defense to violations of the CSA:

> "Those who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financial laws."[79]

The 2011 statement resulted in another round of widespread crackdowns on the medical cannabis industry.[80] Attempts to seize business assets related to the medical cannabis industry continued until earlier this year when the U.S. Attorney for the Northern District of California dropped a civil forfeiture case against one of California's largest dispensaries. Some feel this marks a final shift away from federal prosecution of state legal businesses for violation of federal drug laws.[81]

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[76] Id.
[77] Id at 2.
[78] Q&A With Former DOJ Deputy Attorney General James Cole, supra.
[79] U.S. Deputy Attorney General James Cole, *Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use* (June 29, 2011).
[80] Q&A With Former DOJ Deputy Attorney General James Cole, supra.
[81] Mollie Reilly, *Feds Drop Case Against Influential Medical Marijuana Dispensary*, Huffington Post (May 3, 2016). On November, 1, 2016, a federal judge dismissed with prejudice the last outstanding civil forfeiture action against a medical marijuana business in California. See also *California dispensary ruling 'great' for marijuana industry*. Marijuana Business Daily (November 2, 2016) http://mjbizdaily.com/judges-ruling-for-ca-dispensary-is-great-for-marijuana-industry. Accesses 11-2-2016.

Appendix C
Oregon's History with Cannabis and Regulatory Structure

Oregon has a long history with cannabis. It has long been a "supply state."[82] By some estimates Oregon grows 4-5 times the amount of marijuana it consumes. Oregon's relationship with legalizing marijuana goes back to 1973 when it became the first state to decriminalize small amounts of marijuana.[83] The decriminalization was rolled back in 1997 when criminal penalties were reinstated by the Legislative Assembly.

In 1998, two successful Ballot Measures 57 and 67, respectively, allowed the cultivation, possession, and use of marijuana by prescription by patients with certain medical conditions. The Oregon medical marijuana program (OMMP) has been administered by the Oregon Health Authority (OHA) since 1998. In June 2010, the Oregon Board of Pharmacy, recognizing therapeutic uses of cannabis, reclassified marijuana from a Schedule I to a Schedule II drug.[84] The Oregon Board of Pharmacy's action did not affect federal law, but it made Oregon the first state to make marijuana less serious than a Schedule I drug. In 2013, after a 2010 failed initiative, the Oregon Legislative Assembly adopted HB 3460 which created a retail structure for medical marijuana dispensaries.[85]

Oregon's marijuana regulatory structure

Oregon, like Washington and Colorado, developed its regulatory scheme specifically to address federal enforcement priorities. Vetting and licensing prevents criminal enterprises from profiting. Seed-to-sale tracking prevents diversion to the black market and to other states. Informational campaigns targeted at young audiences, licensing sales representatives, and I.D. requirements help prevent sales to minors. Tax revenues are allocated to law enforcement, addiction services, and education, ensuring the state has adequate resources to continue to address the impact of legalized cannabis on public health and safety. Oregon's marijuana program impacts a number of state agencies, but four have express responsibilities to develop and administer Oregon's marijuana laws in a way that addresses the federal enforcement priorities: the Oregon Liquor Control Commission (OLCC), OHA, Oregon Department of Agriculture (ODA), and Oregon's Department of Revenue.

Oregon voted to legalize adult recreational marijuana in 2014. Measure 91 contained the outline of a regulatory structure for recreational cannabis but specifically sought to maintain the medical marijuana program without changes. Measure 91 made adult possession of marijuana legal on July 1, 2015, and required the Oregon Liquor Control Commission to develop a licensing and regulatory structure to begin accepting applications as of January 1, 2016. The measure required the licensing of growers, processors, distributors, and retail stores. In 2015, the Legislative Assembly amended Measure 91, addressing the split of regulatory responsibility among the OHA, the OLCC, and the ODA, for administering and enforcing a "robust" regulatory structure.

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[82] Eric Fisher, Oregon State Patrol Sergeant and INET Director, Banking Marijuana Related Businesses, Oregon SAR Review Regulatory Panel (May 19, 2016).
[83] House Bill 3643(1997) increased the penalty for possession of less than an ounce of marijuana from a non-criminal "violation" to a class C misdemeanor crime.
[84] Andy Dworkin, *Recognizing medical marijuana, state pharmacy board changes its legal classification*, The Oregonian (June 6, 2010).
[85] 2013 Oregon Laws chapter 726.

Recognizing that a gap between legal possession and legal retail implementation dates would foster illegal sales, the Legislative Assembly implemented an "early sales" program for recreational marijuana. Senate Bill 460 allowed existing medical dispensaries to sell to recreational customers beginning October 1, 2015, while the state recreational structure got up and running.[86]

The OLCC is tasked with licensing and enforcement of the recreational program. There are five recreational marijuana license types: Producer, Processor, Wholesaler, Retail, Laboratory, and a Certificate for Research. There is also a "handler card" required for persons employed by licensed businesses. The OLCC took a staggered licensing approach beginning January 2016. It prioritized licensing on a supply chain model, beginning with producers/growers, then processors, laboratories and wholesalers, and retailers and handlers. All licensing has a criminal background check component. This helps address the federal concern over criminal involvement in, or profit from, Oregon's legal marijuana market. All license types must receive training on, and utilize, the OLCC's tracking program.

The OLCC Cannabis Tracking System (CTS) is referred as seed-to-sale tracking. The system lists 14 different cannabis related items spanning the gamut from seeds to waste. Licensed producers, or growers, are required to track all cannabis products with a unique identity number. In addition, the Department of Revenues tax system and the CTS can work together to trace back through sales recorded and tax paid. Tracking at all levels prevents diversion out of the legal, regulated, market controlling for the federal priorities of keeping marijuana from crossing into other states and diversion to the black market. While medical cannabis patients are not required to track the plants that they grow for themselves, anyone who grows for another must track, in the aggregate, the amount of useable product that they transfer to patients or dispensaries solely for medical cardholder use. Likewise, canopy limits on the different licensing tiers will help to regulate the amount of marijuana that is available, hopefully choking off the supply to the black market.

As a part of licensing, applicants must submit a Land Use Compatibility Statement. This ensures that canna-businesses are sited in accordance with state and local law. It protects against production and processing marijuana on federal lands. OHA rules provide that a grower may have six plants per patient up to a maximum of 12 plants in city limits or in residentially zoned area.[87] The plant limit per patient is aimed at ensuring that excess marijuana – beyond that transferred back to a patient – does not make its way into the black market.

In July 2016, the OLCC began processing worker's permits (similar to alcohol server permits). Licensing and training handlers to card persons attempting to buy marijuana protects against the sale of product to minors. Marijuana must be tested by a lab accredited by the Oregon Environmental Laboratory Accreditation Program (ORELAP), a division of the Oregon Health Authority. Testing rules were developed by the OHA in order to test the potency of the plant and derived products and also for the presence of pesticides or other impurities that could impact public health. The OHA's additional duties include setting labeling requirements on products in consultation with the OLCC and establishing a testing system for contaminants. The Oregon Department of Agriculture regulates the production, processing, and distribution of food

[86] Oregon Laws 2015 chapter 784.
[87] Medical growers may have up to 48 plants outside city limits or in non-residential zones.

products. It ensures that marijuana edibles are manufactured according to the same standards of that of other foods, safeguarding public health.

The OHA continues to oversee medical dispensaries participating in the early sales program and will do so through December 2016, when the early sales program expires. A reporting system for sales and tax data for "early sale" dispensaries has been in place since April 2016. By September 23, the OLCC had issued 296 licenses. As of October 5, 2016, a year in to the recreation sale of marijuana, 26 retail stores had received a license. Retail establishments will be able to sell product until the end of the year or until March 1, 2017, if they have begun the OLCC licensing process. After that point, Oregon's regulatory requirements will be fully established.

Evidence of Current Access To Accounts

State agencies have reported that they are receiving some licensing and tax payments through electronic systems or via checks. The OLCC provides an online licensing platform through a third party vendor. The OLCC says most applicants are using electronic payment options for license fees, though the agency is ready to accept cash if necessary. Likewise, the Department of Revenue originally estimated that 40—80% of tax payments would be in cash; actual payments have been about 65% cash. Because the first round of licensing involved growers/farms, financial institutions may be unaware these account holders are canna-businesses. Alternately, prospective licensees may have access to bank accounts because they are not yet a canna-business, as they go through the process to become licensed and begin business. The agencies have speculated that once financial institutions realize that existing accounts have been used to pay for canna-business licenses that they will close the accounts. DoR is looking at other payment mechanisms including money orders and cashiers checks, but believe that large retailers supplying the payment instruments will find they are running afoul of money laundering statutes.

OHA requires electronic payments for dispensaries and reports that patient fees are usually paid by check. OHA has advised persons/businesses to get a prepaid card to use in respect to the registration if they do not otherwise have a bank account that can be used. Anecdotally, businesses report using holding companies or personal accounts to disguise the nature of their business in order to open depository accounts. Noah Stokes, the CEO of CannaGuard Security related that he has heard that more businesses are finding depository accounts.[88]

[88] The Big Idea: Cannabis.