

July 23, 2019

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*Testimony of*

**Joanne Sherwood**

*On behalf of the*

**American Bankers Association**

*before the*

**Banking, Housing, and Urban Affairs Committee**

*Of the*

**United States Senate**

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Chairman Crapo, Ranking Member Brown, and members of the committee, I am Joanne Sherwood, President and CEO of Citywide Banks and Chair of the Colorado Bankers Association. Citywide Banks is headquartered in Denver, Colorado with \$2.3 billion in total assets.

I appreciate the opportunity to present the views of the American Bankers Association (ABA) regarding the federal prohibition preventing banks from handling money related to cannabis businesses. ABA is the voice of the nation's \$18 trillion banking industry, which is composed of small, midsize, regional and large banks that together employ more than two million people, safeguard nearly \$14 trillion in deposits, and extend \$10 trillion in loans.

ABA supports S. 1200, the SAFE Banking Act and we are grateful to Chairman Crapo and Ranking Member Brown for your leadership in holding a hearing to discuss this urgent issue. While some lawmakers would prefer to avoid this subject, voters have made it clear that this issue is not going away – with 33 states already having approved cannabis use and as many as seven more states with potential cannabis-related initiatives on the ballot in 2020.

Since 1996, voters across the country have determined that it is appropriate to allow their citizens to use cannabis for various purposes. In Colorado, voters approved medical cannabis in 2000 and voted to approve recreational cannabis sales in 2012.

As the legal state-cannabis industry continues to grow, the indirect connections to cannabis revenues will also continue to expand. Without congressional action and clearer guidance from banking regulatory agencies, that entire portion of economic activity, which operates across all 50 states, may be marginalized from the banking system.

Despite the majority of states having adopted cannabis regimes of some kind, federal law prevents banks from banking cannabis businesses. Specifically, The Controlled Substances Act (21 U.S.C. §801 et seq.) classifies cannabis as an illegal drug and prohibits its use for any purpose. For banks, that means that any person or business that derives revenue from a cannabis firm – including real estate owners, security firms, utilities, vendors and employees of cannabis businesses, as well as investors – is violating federal law and consequently putting their own access to banking services at risk.

### **Unintended Consequences are Significant if Cannabis Businesses Cannot Be Banked**

Because cannabis continues to be illegal at the federal level, handling funds associated with cannabis businesses can be deemed money laundering. That federal/state divide has particularly severe repercussions for banks and communities like mine, where the cannabis industry is fully operational, but it also impacts banks in every state.

In Colorado, there was over \$1.5 billion in total cannabis sales in 2017, with almost \$600 million in total sales in the city of Denver. With limited access to banking services available, there exists a cash economy for cannabis which lacks visibility from a regulatory and taxation perspective. Large amounts of cash remain on site in many of the cannabis related businesses which creates significant safety concerns for the communities where they are located. To give you a sense of the scope of this problem, there are approximately 500 unique locations for licensed cannabis business in Denver alone.

For banks in states like Idaho and Nebraska, where cannabis has not been legalized for any purpose, there are still significant compliance challenges that must be addressed. Cannabis businesses operating in states where it is legal rely on suppliers, service providers and even investors to support their business operations. For example, the bank may have a customer that is an agribusiness, a law firm, a payroll company, or a real estate investor whose business derives some measure of revenue from a cannabis related business in a neighboring state. As a result, a bank may inadvertently serve businesses and individuals that have connections with and receive funds from legal state cannabis companies in a nearby state despite the bank's best efforts to identify and prevent cannabis-related funds of any kind from entering the bank. Bank customers do not contain their financial activity within state boundaries, and their economic interactions are varied and may only be tangentially related to a state cannabis business.

Short of terminating their relationships with all of these customers who are otherwise unrelated to cannabis but which do receive money from a cannabis-related business, the bank must dedicate significant resources to developing a compliance strategy that allows them to continue to serve their communities in an environment where the letter of federal law and the reality of the current marketplace are irreconcilable.

### **Many Benefits Accrue From Enabling Banks to Serve this Market**

In addition to the unintended consequences for ancillary businesses, communities with legalized cannabis are also struggling to address the significant challenges to public safety, regulatory compliance and tax compliance that go together with cash-reliant businesses. For example, in Denver, cannabis businesses make up less than 1% of all local businesses but have accounted for 10% of all reported business burglaries from 2012-2016. On average, more than 100 burglaries occur at cannabis businesses each year according to the Denver Police Department, and burglaries and theft comprise almost 80% of Denver's cannabis industry-related crime. Providing a mechanism for the cannabis industry to access the regulated banking system would help those businesses and their surrounding communities by reducing the high-volume of cash on hand, thereby reducing instances of cash-motivated crime.

Access to the banking system would also increase the efficiency of tax collections and improve the financial transparency of the cannabis industry. Since many cannabis businesses do not have a bank account, they are forced to pay their taxes *in cash* at local IRS offices. Processing such paper-based returns costs the IRS nearly 17 times more compared to an e-filed return, and sometimes requires local tax offices to invest in additional security measures because of the cash payments. Those costs are ultimately borne by taxpayers and could be avoided by allowing cannabis businesses access to bank accounts, which enable electronic tax payments.

Due to the lack of transparency associated with cash-based transactions, taxpayers are also less likely to report cash income than payments received by check or those subject to third-party reporting or withholding. Although the cannabis industry is regulated and therefore likely more tax-compliant than unregulated cash-based businesses, initial studies show that there are still significant tax evasion challenges in the current cannabis environment. The city of Sacramento, for example, estimated that cannabis dispensaries are underpaying their taxes by up to \$9 million per year due to poor recordkeeping or filing of inaccurate financial statements with local tax collectors. Given that tax revenues from the cannabis industry are often earmarked for education and public health

initiatives, compliance is critical to the well-being of local communities. Banking the cannabis industry is a straightforward way to ensure that businesses have the means and motivation to remain fully tax compliant.

Allowing cannabis related businesses access to the regulated banking system would also improve federal and state oversight of their financial activities. Bank accounts are monitored in accordance with existing anti-money laundering and Bank Secrecy Act requirements which help law enforcement to identify and address suspicious transactions – an opportunity that is not available in an all-cash environment. One of the foundations of the Bank Secrecy Act (BSA) is the transparency provided by bank records of transactions. In fact, when adopting the BSA in 1970, Congress found that records maintained by businesses “have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings.” The increased transparency that would come from processing transactions through bank accounts instead of in cash would ensure that regulators and law enforcement have the necessary tools to identify bad actors and remove them from the marketplace. The activity of cannabis businesses would become part of the standard process that all banks apply to their customers to understand customer profiles, assess risk, and monitor for and report possible suspicious activity and large cash transactions.

For example, currently, when banks open accounts, they verify the identity of the individuals opening the account and create a risk profile for the customer based on a variety of factors: the bank products used, the type of business the customer is in, where the company plans to do business, and its existing relationships with the bank, among others. Then, once the account is opened, the bank will monitor transactions to ensure that the customer is operating in accordance with the profile presented at account opening. If something unusual or out of the ordinary occurs that cannot be explained, the bank will report that to the appropriate authorities by filing a Suspicious Activity Report (SAR). In addition, if the customer engages in a large cash transaction, the bank generally will file a Currency Transaction Report with FinCEN. If a customer is operating on an all-cash basis without a bank account, none of that takes place and if unusual transactions occur, it is not reported to FinCEN.

Despite the myriad benefits that would result from banking this fledgling industry, widespread and consistent financial services will not be possible until Congress removes the risk of Controlled Substances Act liability and directs the federal banking regulators to issue guidance to help banks understand what procedures are acceptable. Currently, the only direction available to

financial institutions in connection with cannabis-related accounts comes from guidance issued by the Financial Crimes Enforcement Network (FinCEN) in 2014. That guidance, which references a now rescinded memorandum from the U.S. Department of Justice (the “Cole Memo”), describes how financial institutions can report cannabis-related business activity consistent with their Bank Secrecy Act obligations where there is this conflict between state law which makes an activity legal and federal law which prohibits it. It does not create a safe harbor or otherwise modify federal law to protect banks from criminal and civil liability for money laundering. The guidance specifically reminds banks that marijuana continues to be illegal under federal law.

Although a small number of financial institutions have weighed the prevailing climate of non-enforcement and have decided to shoulder the risk in order to serve the needs of their communities, the majority of financial institutions will not accept the legal, regulatory, or reputational risk associated with banking cannabis-related businesses absent congressional permission to do so. Because Congress has banned marijuana, whether for medicinal or adult use, it will require action by Congress to allow banks to serve this industry.

### **The SAFE Banking Act Would Help Address the Problem**

The bipartisan SAFE Banking Act (S. 1200), which is before the Committee for consideration, would help address this urgent banking problem. The bill specifies that proceeds from a state licensed cannabis business would not be considered unlawful under federal money laundering statutes or any other federal law and directs FinCEN and the federal banking regulators to issue guidance and exam procedures for banks doing business with cannabis related legitimate businesses. Explicit, consistent direction from federal financial regulators will provide needed clarity for banks and help them to better evaluate the risks and supervisory expectations for cannabis-related customers.

Although the SAFE Banking Act does not cure all of the cannabis-related banking challenges, it would help the 33 states that have legalized cannabis in some form to make their communities safer, collect their taxes, and regulate their cannabis markets effectively. It would also help banks and their customers in states without legal cannabis regimes by addressing the unintended consequences for unrelated businesses that provide products and services to the cannabis industry, their employees or service providers, without undermining each state’s ability to prohibit cannabis sales and use within their borders.

## **Summary**

ABA supports the SAFE Banking Act and urges the Committee to markup and advance this legislation as soon as possible. Approving a narrow, banking specific remedy will reap immediate public safety, tax and regulatory benefits without undermining broader deliberations about national drug policy that will take more time.

Thank you for your efforts to address this important issue that has become a challenge for many of our nation's communities and the banks that serve them. I am happy to answer any questions you may have.