
**SENATE COMMITTEE ON
BANKING AND FINANCIAL INSTITUTIONS**
Senator Steven Bradford, Chair
2019 - 2020 Regular

Bill No:	SB 51	Hearing Date:	April 3, 2019
Author:	Hertzberg		
Version:	March 25, 2019 Amended		
Urgency:	No	Fiscal:	Yes
Consultant:	Eileen Newhall		

Subject: Financial institutions: cannabis

SUMMARY This bill authorizes the creation of limited charter banks and credit unions, as specified, and authorizes the use of special purpose checks issued by these institutions for certain purposes, including the payment of state and local taxes, rent, and goods and services, and the purchase of state and local securities, as specified.

EXISTING LAW

- 1) Provides for Proposition 215 (The Compassionate Use Act of 1996), which exempts from specified criminal penalties the possession or cultivation of medical marijuana by patients and primary caregivers; and Proposition 64 (The Control Regulate, and Tax Adult Use of Marijuana Act of 2016), which provides for the licensure and regulation of commercial adult marijuana activities by various state agencies.
- 2) Provides for the Medicinal and Adult-Use Cannabis Regulation and Safety Act (Business and Professions Code Section 60000 et seq.) and its implementing regulations (California Code of Regulations Title 16, Division 42, Section 5000 et seq.), administered by the California Bureau of Cannabis Control.
- 3) Provides for the Department of Business Oversight (DBO) and gives DBO authority to administer the Financial Institutions Law. The three divisions of the Financial Institutions Law that are relevant for purposes of this bill include Division 1, related to administration, enforcement, and liquidation and conservation (Financial Code Section 99 et seq.); Division 1.1, the Banking Law (Financial Code Section 1000 et seq.); and Division 5, California Credit Union Law (Financial Code Section 14000 et seq.).

THIS BILL

- 1) Contains findings and declarations related to passage of Proposition 64 in 2016, authorizing the recreational use of cannabis, and to passage of Proposition 215 in 1996, authorizing the medicinal use of cannabis; the significant challenges that cannabis businesses have accessing traditional banking services; the regulatory and public safety issues arising from cannabis businesses' lack of access to banking services; and the responsibility of the state, consistent with the will of California voters, to provide a mechanism to help lawful cannabis businesses gain access to banking services.

- 2) Establishes a new Division 2.5 within the Financial Code (Section 11000 et seq.) called the Cannabis Limited Charter Banking and Credit Union Law (CLCL), administered by DBO. Sunsets this division on the earlier of either of the following:
 - a) The federal government, by legislative or executive action, removes cannabis and cannabis-related substances from the schedule of controlled substances, as defined in the federal Controlled Substances Act (21 U.S.C. Sec.812; 21 C.F.R. Part 1308).
 - b) The federal government enacts legislation that would establish protections for depository institutions that provide financial services to cannabis-related legitimate businesses.

Provides that, within thirty days of an event described above, DBO must post notice of that occurrence on its Internet website, send notice to both the Secretary of State and the Office of Legislative Counsel, and provide guidance for the orderly of entities chartered under Division 2.5, as specified.

- 3) Defines the terms banking services, board, cannabis business, cannabis limited charter bank (CLCB), and cannabis limited charter credit union (CLCCU) for purposes of the CLCL.
- 4) Authorizes CLCBs and CLCCUs to issue special purpose checks, which are valid only for specified purposes, and to cash special purpose checks, as specified. Requires each special purpose check to include the following text, in at least 12-point type: "This check is issued by [insert name of CLCB or CLCCU] and may only be deposited or cashed at this CLCB/CLCCU or another CLCB/CLCCU that agrees to accept the check."
- 5) Allows special purpose checks to be used only for specified purposes, but clarifies that no individual or entity, whether private or public, is required to accept a special purpose check issued by a CLCB or a CLCCU. Special purpose checks may only be used to:
 - a) Pay fees or taxes to the state or a local jurisdiction.
 - b) Pay rent on property that is leased by or on behalf of the account holder's cannabis business.
 - c) Pay a vendor physically located in California for expenses related to goods and services associated with the account holder's cannabis business.
 - d) Purchase bonds or interest-bearing notes or warrants backed by the full faith and credit of the state, or bonds or warrants of any local jurisdiction, as specified.
- 6) Authorizes CLCBs and CLCCUs to cash special purpose checks they previously issued, if those checks are presented to them by non-account holders and the checks were used for one of the aforementioned authorized purposes.

- 7) Requires persons wishing to form as a CLCB or CLCCU to obtain a license from DBO, as specified, and to comply with all requirements of Division 1 of the Financial Institutions Law (which generally cover administrative and enforcement functions) and with either Division 1.1 of the Financial Code (the Banking Law) or Division 5 of the Financial Code (the California Credit Union Law), as applicable, but further provides that any requirement of any of those laws that is inconsistent with Division 2.5 does not apply to that CLCB or CLCCU.
- 8) Requires CLCBs and CLCCUs to adopt policies and practices that allow them to achieve the principles and goals outlined in the federal Bank Secrecy Act and to cooperate with the federal Financial Crimes Enforcement Network.
- 9) Requires CLCBs and CLCCUs to obtain and maintain private insurance for themselves and their assets at all times they are engaged in banking services, and authorizes CLCBs and CLCCUs to do all things and assume and discharge all obligations required of them in this regard, which are not in conflict with state law.
- 10) Subject to the approval of DBO, authorizes CLCBs and CLCCUs to enter into agreements with one or more other limited charter licensees in order to form a banking network for the purpose of helping each other provide services to cannabis businesses and each other, but expressly provides that a network of this type may not include any institution that is not a cannabis limited charter depository.
- 11) Authorizes CLCBs and CLCCUs to charge fees for the services they provide and requires each of these entities to conspicuously post the types and amounts of fees it charges on its Internet website in a format intended to provide transparency.
- 12) Requires DBO to adopt emergency regulations to implement the CLCL and provides that DBO may not issue CLCB or CLCCU licenses before July 1, 2020, except as specified.
- 13) Establishes the Cannabis Limited Charter Bank and Credit Union Law Advisory Board (board) and provides that the board is comprised of the State Treasurer, State Controller, and the Chief of the Bureau of Cannabis Control as voting members, and the Director of the Department of Finance as an ex-officio, nonvoting member.
 - a) Holds the Board generally responsible for ensuring that the CLCBL provides a safe and efficient way to pay state and local taxes and fees, pay rent associated with the account holder's cannabis business, issue special purpose checks, and legally invest in California's economy.
 - b) Requires the Board to hold noticed, public meeting at least once a year, or more often as needed, to review enforcement activity reports from DBO and to draft recommended legislative or administrative actions for submission to the Legislature and the Governor, as specified.
 - c) Requires the Board to provide guidance and education to registered broker-dealers and licensed investment advisors on how to accommodate CLCB and CLCCU account holders who wish to purchase allowable state and/or local

securities.

d) Expressly prohibits Board members from being compensated for their services.

14) Makes related conforming amendments.

COMMENTS

- 1) Purpose: This bill is sponsored by Treasurer Fiona Ma to help mitigate several of the problems resulting from cannabis businesses' lack of access to banking services.
- 2) Author's Statement: The author states, "The use and consumption of medical marijuana was legalized in California in 1996, and Proposition 64 legalized adult-use cannabis as of January 2018. However, due to cannabis' federal classification as a Schedule I drug, cannabis-related businesses are not able to deposit income with federally-insured financial institutions. The cannabis industry is expected to generate between \$8-20 billion annually. This is a massive industry that we can only expect will continue to grow; yet cultivation, distribution, and retail businesses alike have been forced to operate on a cash-only basis. This is not only impractical from an accounting perspective, but also presents a significant public safety issue.

"The Department of Finance estimates that the state will collect \$600 million in cannabis taxes in the upcoming year. Unlike most businesses however, cannabis businesses arrive to government offices with duffel bags of cash to fulfill their tax obligations. Standard oversight and accountability measures, like audits, become very difficult when most transactions are completed in cash. Additionally, these businesses face security risks because of the volume of cash in their possession."

- 3) Why Are Depository Institutions Reluctant to Bank Cannabis Businesses? Virtually everyone who has attempted to solve the problem this bill's author and sponsor are seeking to solve has faced the reality that the vast majority of traditional banks and credit unions will not knowingly provide banking services to cannabis businesses or, in many cases, to businesses that serve cannabis businesses. Reluctance to serve the cannabis industry is based on a minimum of four different federal laws: the Controlled Substances Act, Bank Secrecy Act, USA Patriot Act, and Racketeer Influenced and Corrupt Organizations (RICO) Act. The Controlled Substances Act classifies marijuana as a Schedule I drug, whose manufacture, distribution, dispensing, and possession are illegal under most circumstances. The other three listed laws make it illegal for financial institutions to handle funds stemming from criminal activity, including violations of federal drug laws, and subject financial institutions to possible regulatory sanctions for placing their safety and soundness at risk by failing to take appropriate actions to avoid illegal activity. The RICO Act additionally subjects all property bought with the proceeds of illegal activity to forfeiture.

A feasibility study prepared for former State Treasurer John Chiang summarized the issues this way: "The fact that cannabis remains a schedule one illegal drug at the federal level, in the same class as heroin and LSD, places a "Sword of Damocles" over the state in that the federal government could, if desired, prosecute anyone

involved in the cannabis industry (directly or indirectly) under federal drug laws; and confiscate all funds and cannabis-related property. Accordingly, the banking industry is faced with at least four challenges when servicing the industry:

- “1. The bank may be at risk of criminal or civil liability under federal drug and banking laws.
2. The industry is new, rapidly evolving, and large. This creates business risks even without federal enforcement of the federal drug laws.
3. There is a significant administrative burden to properly file the required federal reports governing cannabis banking transactions, and the penalties for incorrect filings may be severe.
4. The “Know Your Customer” requirements are more significant than normal because similar transactions may be allowed (e.g., proceeds from the sale of cannabis within the state) or not allowed (e.g., illegal proceeds from sale of cannabis to another state).

“As a result, banks are only gradually entering this market. This limits the ability of cannabis businesses to operate in a normal business fashion using checks, credit cards, electronic transfers, and so on.” (“State-backed Financial Institution (Public Bank) for the State of California Servicing the Cannabis Industry Feasibility Study, 2018,” Level 4 Ventures, available at: <https://www.treasurer.ca.gov/comm-external-urls/cannabis-feasibility-full-report.pdf>).

The feasibility study referenced immediately above noted that, “even with no state intervention, private financial institutions are gradually entering the cannabis market. This trend is expected to continue.” However, the report also acknowledged that the number of institutions in California willing to knowingly serve the cannabis industry does *not* meet the demand among this industry for banking services. This bill is an attempt to help bridge that gap.

- 4) How Will All of This Work? If this bill is enacted, the author and sponsor envision that one or more CLCBs or CLCCUs will form in one or more areas of the state. Once formed and operational, a CLCB or CLCCU will open accounts for California licensed cannabis businesses and accept cash and special purpose check deposits from those businesses. CLCBs and CLCCUs will be authorized to engage in only two activities: 1) accepting and holding deposits for their account holders and 2) issuing special purpose checks to their account holders. A cannabis business with an account at a CLCB or CLCCU will be able to use special purpose checks, rather than cash, to pay taxes and to pay for certain products and services, but only if the entity to which the cannabis business presents the special purpose check wishes to accept it. Because traditional banks and credit unions will be unlikely to deposit or cash special purpose checks, these checks cannot be considered legal tender. They are, in essence, cannabis scrip, which can only be exchanged with a business or other entity that agrees to accept them.

One potential benefit of the system proposed by this bill involves the increased ability of cannabis businesses to pay their state and local taxes with special purpose checks, without having to physically carry large bags of cash into state and local taxing agencies. However, this benefit will only be realized if the state and local taxing agencies accept special purpose checks for tax payments.

Other advantages may also flow from the authority granted by this bill, but may be limited in geographic scope, at least initially. For example, in certain geographic areas of the state whose economies are heavily reliant on cannabis, and whose residents and business owners frequently interact with cannabis businesses, the special purpose checks envisioned by this bill may be readily accepted, and, as such, may help take some cash off the streets and mitigate some of the existing public safety risks that result from cannabis business's lack of access to banking services. If everyone has an account at the local CLCB or CLCCU, being presented with a special purpose check is not a problem; one just deposits it into one's account. Even in areas where the economy is less dependent on cannabis, and where most residents and businesses do not interact with cannabis businesses, these special purpose checks may help cannabis businesses interact with one another, without having to exchange large amounts of cash. One's out-of-town landlord may not want to accept a special purpose check, but the vendor that serves multiple cannabis businesses probably will.

However, in other areas of the state whose economies are less reliant on cannabis, and where residents and businesses interact to a much more limited extent with cannabis businesses, these special purpose checks may not be readily accepted. If a landlord receives a special purpose check from a cannabis business but does not have an account at a CLCB or CLCCU, the landlord has little, if any, ability to convert that check to cash. Even if the landlord has access to a nearby CLCB or CLCCU, something that is not assured, it is unclear how much that landlord would be charged for turning the special purpose check into cash at the limited charter depository. The fewer CLCBs and CLCCUs that form under the authority created by this bill, the harder it will be for cannabis businesses wishing to use special purpose checks in lieu of cash to find people and businesses to accept them.

It should also be noted that, even though this bill authorizes different CLCBs and CLCCUs to enter into banking networks with one another, this authority does not extend to electronic transmission of money from one to another. This bill does nothing to grant CLCBs or CLCCUs access to federal payment rails, access that cannot be granted as long as cannabis remains illegal at the federal level.

The idea in this bill may hold promise, but its success will be heavily dependent on the number of CLCBs and CLCCUs that form, on their geographic locations across the state, and on their abilities to devise ways to accept and deposit checks issued by their brother- or sister- CLCBs and CLCCUs.

- 5) Will Private Insurance Be Available? What About Sufficient Collateral to Ensure Liquidity? Several of the unanswered questions surrounding the limited purpose depository institution charter authorized by this bill include the level of private deposit insurance and collateral DBO will require, the extent to which insurers authorized to do business in this state will provide the required insurance, the cost of that insurance, and the extent to which limited charter banks and credit unions will have access to required amounts of collateral. No cannabis business, regardless of how desperate it is to move away from an all-cash business model, is likely to deposit its money in an institution that might not fully insure its deposits, nor in one that cannot

promise instant liquidity, when it wishes to withdraw its funds.

- 6) Should This Bill Spell Out the Specific Requirements to Which CLCBs and CLCCUs are Subject? This bill opts to use general control language to describe the requirements to which CLCBs and CLCCUs are subject, rather than spelling out each and every requirement in detail. For example, Financial Code Section 11021, proposed to be added by this bill, states that a CLCB and CLCCU shall comply with all requirements of Division 1 of the Financial Code, and with either Division 1.1 (CLCBs) or Division 5 (CLCCUs), except that, to the extent any requirement of those laws is inconsistent with a provision of the Cannabis Limited Charter Banking Law, the provisions of the cannabis law shall prevail. The challenge posed by this broad language is its lack of specificity. Which requirements are inconsistent? Should they be ignored or should they be modified to remove the inconsistency? If the latter, how, exactly, should they be modified?

Without further clarity around these questions, it is unlikely that any businesses will apply to become CLCBs or CLCCUs, because their governing boards and risk committees will be unclear about DBO's specific compliance expectations. The question is not, "will entities want or need this clarity" but rather, "where will the clarity originate?" The Senate Banking and Financial Institutions Committee analysis of last year's SB 930 suggested amendments to provide such clarity through statute. This bill's author rejected that amendment, preferring instead for DBO to provide any clarity that proved necessary in its implementing regulations. It is currently unclear how much clarity DBO expects to provide around these questions in the emergency regulations this bill requires the department to promulgate by July 1, 2020.

- 7) How Much Will This Cost? According to the Assembly Appropriations Committee analysis of SB 930, last year's bill would have resulted in ongoing costs to DBO in the range of \$2 million annually to adopt regulations, process applications, conduct examinations, and enforce the provisions of the bill. These cost estimates rely on optimistic assumptions that enough banks and credit unions participate in the closed-loop system to make it viable. Costs would be lower if no institutions apply for or are granted cannabis limited charters, although DBO would still incur initial costs to promulgate regulations and develop a new regulatory program.

8) Support:

- a) State Treasurer Fiona Ma is sponsoring SB 51, just as she sponsored last year's SB 930 in her capacity as a member of the Board of Equalization. Treasurer Ma asserts that "SB 51 is a significant step toward integrating cannabis-related businesses into the California economy in a safe and transparent manner."
- b) Numerous other supporters submitted identical letters of support in which they asserted that SB 51 offers a practical solution to the problems faced by an unbanked cannabis industry. The cannabis industry "is a massive industry that we can only expect will continue to grow; yet cultivation, distribution, and retail businesses alike have been forced to operate on a cash-only basis. This is not only impractical from an accounting perspective, but also presents a significant public safety issue."

- 9) Opposition: The Siskiyou County Sheriff's Department opposes this bill, on the basis that it will further exacerbate an out-of-control and largely unethical marijuana industry and will promote wholesale money laundering. Siskiyou County has more than 1500+ illegal marijuana sites on private property, and more in public land areas. This bill, if passed, will lead to more criminalization and victimization.
- 10) Prior and Related Legislation:
- a) SB 930 (Hertzberg, 2018) was substantially similar to this bill. SB 930 was held on the Assembly Appropriations Committee Suspense file.

LIST OF REGISTERED SUPPORT/OPPOSITION

Support

Treasurer Fiona Ma (sponsor)
 Aeon Botanika
 Budberry
 California Asian Pacific Chamber of Commerce
 California Cannabis Industry Association
 California NORML
 City of Irvine Councilmember Melissa Fox
 City of Santa Monica
 Eaze
 El Capitan
 Gallegos Law Firm
 Green Believers
 Hard Car Security
 La Vida Verde
 Loudpack
 Lovingly & Legally
 National Cannabis Industry Association
 Origin House
 Rezai, Khorsandi & Lahijani
 Rural County Representatives of California
 San Francisco Cannabis Retailers Alliance
 Sespe Creek Collective
 Southern California Coalition
 The Artist Tree
 TreeHouse
 Undeniable INC
 United Cannabis Business Association
 Vanguard Concepts
 VCC Brands

Opposition

Siskiyou County Sheriff's Department

-- END --