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# SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Mike McGuire, Chair  
2019 - 2020 Regular

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<b>Bill No:</b>	SB 51	<b>Hearing Date:</b>	4/24/19
<b>Author:</b>	Hertzberg	<b>Tax Levy:</b>	No
<b>Version:</b>	3/25/19	<b>Fiscal:</b>	Yes
<b>Consultant:</b>	Brown		

## *FINANCIAL INSTITUTIONS: CANNABIS*

*Authorizes the creation of both cannabis limited charter banks and credit unions and authorizes the use of special purpose checks issued by these institutions for specified purposes.*

### Background

**Federal law relating to cannabis.** Federal law prohibits the manufacture, possession, sale, or distribution of cannabis. In 1970, Congress enacted the Controlled Substances Act (CSA), which sets forth five schedules of specified drugs. For a drug to be designated a Schedule I controlled substance, CSA states the substance must have “a high potential for abuse,” and have “no currently accepted medical use” in the United States. Federal law lists cannabis as a Schedule I controlled substance.

**State law relating to cannabis.** In 1996, California voters approved Proposition 215, known as the Compassionate Use Act of 1996 (CUA). Under CUA, qualified patients with specified illnesses—and their primary caregivers—cannot be prosecuted for possessing or cultivating cannabis upon the written or oral recommendation or approval of an attending physician. In other words, CUA allowed qualified patients and primary caregivers to obtain cannabis for medicinal use.

The Legislature clarified CUA by enacting SB 420 (Vasconcellos, 2003), which established and maintained a voluntary program—The Medical Marijuana Program—where qualified patients could be issued Medical Marijuana Identification Cards (identification cards) when deemed appropriate by their attending physician. Qualified patients with identification cards were exempt from criminal liability for possession, transportation, delivery, or cultivation of cannabis. SB 420 directed the Department of Public Health to administer the program and required county health departments to issue identification cards to patients and primary caregivers who voluntarily registered.

The cannabis industry remained largely unregulated at the state level until 2015, when the Legislature enacted the Medical Marijuana Regulation and Safety Act (MMRSA). MMRSA comprised a package of legislation that comprehensively regulated many aspects of medicinal use cannabis including cultivation, manufacturing, transportation, distribution, sale, and product safety. In 2016, several bills made slight changes to MMRSA, including renaming MMRSA to the Medical Cannabis Regulation and Safety Act.

On November 8, 2016, California voters approved Proposition 64—the Control, Regulate and Tax Adult Use of Marijuana Act (the Act)—which legalized commercial adult-use cannabis for adults age 21 and older. Prop. 64 provides for the licensure and regulation of both commercial adult-use and medicinal use cannabis activities by various state agencies.

Less than a year later in June 2017, the Legislature enacted SB 94 (Committee on Budget and Fiscal Review, 2017), which integrated MMRSA with the Act to create the Medicinal and Adult Use Cannabis Regulation and Safety Act (MAUCRSA). Among other things, MAUCRSA consolidated the licensure and regulation of both commercial adult-use and medicinal use cannabis activities. It established a system of 20 plus license categories, which includes distributor, retailer, and microbusiness, among others. Generally, licenses bear a clear designation indicating whether the license is for commercial adult-use or medicinal cannabis with an “A” or “M” respectively.

**Cannabis taxes.** Prop. 64, and subsequently MAUCRSA, imposes two specific taxes on cannabis: the excise tax and the cultivation tax. A customer who purchases cannabis or cannabis products in the state is subject to the cannabis excise tax, which is equal to 15 percent of the average market price of any cannabis or cannabis products retail sale. A cannabis retailer is responsible for collecting the cannabis excise tax from the customer and remitting it to the distributor. The distributor then remits the cannabis excise tax to the California Department of Tax and Fee Administration (CDTFA).

The cultivator, who grows the cannabis, is subject to the cultivation tax, which applies to all harvested cannabis at the following rates:

- \$9.25 per dry-weight ounce of cannabis flower.
- \$2.75 per dry-weight ounce of cannabis leaves.
- \$1.29 per ounce of fresh cannabis plant.

The cultivation tax is collected by the distributor (or manufacturer), and then remitted to CDTFA. The cultivation tax does not apply to cannabis cultivated for personal use.

**Federal banking laws and money laundering.** The Money Laundering Control Act of 1986 made money laundering—the concealment of the origins of illegally obtained money—a federal crime. Regardless of state law, financial institutions can commit money laundering by conducting financial transactions involving substances explicitly prohibited by CSA, such as cannabis.

Under the Bank Secrecy Act of 1970, financial institutions must assist government agencies in detecting and preventing money laundering: they must conduct sufficient due diligence to assess the risk of doing business with each of its customers. For example, financial institutions must understand its customers’ area of business as well as the nature of its customers’ accounts. They must report any transaction exceeding \$10,000, and any suspicious or illegal activities to the federal Financial Crimes Enforcement Network (FinCEN). If financial institutions do not abide by the Bank Secrecy Act, FinCEN has the authority to seek substantial civil penalties, which often reach well into the millions of dollars, as well as criminal prosecution.

Additionally, under the Racketeer Influenced and Corrupt Organizations (RICO) Act of 1970, the federal government can prosecute all individuals involved in a corrupt organization. RICO subjects all property bought with the proceeds of illegal activity to forfeiture.

**The Cole Memo.** On August 29, 2013, the U.S. Department of Justice (DOJ) issued the Cole Memo, which provided guidance to federal prosecutors regarding cannabis enforcement. The Cole Memo suggested that the federal government may ignore some CSA violations in states that legalize and regulate cannabis use. It instructed DOJ attorneys and law enforcement officials to focus on the following enforcement priorities:

- Preventing the distribution of cannabis to minors.
- Preventing revenue from cannabis sales from going to criminal enterprises, gangs, and cartels.
- Preventing the diversion of cannabis from states where it is legal to other states where it is illegal.
- Preventing state-authorized cannabis activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity.
- Preventing violence and the use of firearms in the cultivation and distribution of cannabis.
- Preventing drugged driving and other adverse public health consequences associated with cannabis use.
- Preventing the growth of cannabis on public lands.
- Preventing the public safety and environmental dangers posed by cannabis production on public lands.
- Preventing cannabis possession or use on federal property.

The Cole Memo's priorities guided the DOJ's enforcement of CSA relating to cannabis nationwide. However, on January 4, 2018, the DOJ rescinded the Cole Memo, which means U.S. Attorneys can resume enforcing all federal cannabis laws in states with legalized cannabis use, like California.

Since cannabis is still illegal under federal law, cannabis businesses have been locked out of the banking system. The author wants to help the recently legal industry access a banking system that is walled off from the traditional banking sector.

### **Proposed Law**

Senate Bill 51 establishes the creation of cannabis limited charter banks (CLCBs) and cannabis limited charter credit unions (CLCCUs) to provide limited banking services to the cannabis industry. Under the administration of the Department of Business Oversight (DBO), CLCBs and CLCCUs can accept and maintain cash deposits as well as issue special purpose checks that can only be used for the following:

- To pay fees or taxes to the state or local jurisdiction.
- To pay rent on property that is associated with the account holder's cannabis business.
- To pay vendors located in California for expenses related to goods and services associated with the account holder's cannabis business.

- To 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.

CLCBs' and CLCCUs' special purpose checks must contain the text "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" in at least 12-point type. While special purpose checks can be used for the specific purposes stated above, neither an entity nor a person is required to accept them.

CLCBs and CLCCUs can charge fees for their services, and must post both the types and amounts of fees on its Internet website in a format intended to provide transparency. CLCBs and CLCCUs may form banking networks only with other CLCBs and CLCCUs, and these institutions are required to obtain private insurance for themselves and their assets. They must 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.

The bill sunsets CLCBs and CLCCUs if either of the following take place:

- The federal government removes cannabis and cannabis-related substances from the federal Controlled Substances Act.
- The federal government enacts legislation that would establish protections for depository institutions that provide financial services to cannabis-related legitimate businesses.

If CLCBs and CLCCUs sunset, the bill requires DBO to post the occurrence on its Internet website, notify both the Secretary of State and the Office of Legislative Counsel, and provide guidance for licensed CLCBs and CLCCUs on how to proceed going forward.

Additionally, it establishes the Cannabis Limited Charter Bank Advisory Board (Board), which comprises the Treasurer, the Controller, and the Chief of the Bureau of Cannabis Control as voting members. The Director of Finance sits on the Board as a non-voting ex-officio member. SB 51 prohibits board members from receiving compensation for their services.

SB 51 requires DBO to issue emergency regulations and prohibits DBO from issuing licenses to CLCBs and CLCCUs until July 1, 2020. The bill requires DBO to report to the Senate Committee on Banking and Financial Institutions (SBFI), and the Senate Committee on Governance and Finance (SGF) regarding the status of its regulations and the implementation of this bill.

DBO may issue licenses prior to July 1, 2020, if all of the following have taken place:

- DBO adopts the emergency regulations required;
- The DBO Commissioner makes a written finding and posts it on the department's website; and
- SBFI and SGF have met in an open and public meeting to discuss the report DBO has submitted.

SB 51 contains findings and declarations as well related to the following:

- The passage of both Proposition 64 and Proposition 215.
- The significant challenges the cannabis business faces with limited access to traditional banking services.
- The regulatory and public safety issues arising from the cannabis industries lack of access to banking.
- The responsibility of the state to provide a mechanism to help the cannabis industry gain access to banking services.

### **State Revenue Impact**

No estimate.

### **Comments**

1. Purpose of the bill. According to the author, “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 California cannabis industry is expected to generate more than \$5 billion in revenue by 2020. 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 tax receipts will only continue to grow in the coming years. 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.”

2. A new approach. SB 51 envisions CLCBs or CLCCUs that are completely walled off from the traditional banking sector. These limited charter banks will form networks with each other and establish branches throughout the state. CLCBs and CLCCUs will open accounts for California licensed cannabis businesses and will provide their customers with two types of services: accepting and holding deposits as well as issuing special purpose checks. Thus, a cannabis business with an account at a CLCB or CLCCU will be able to use special purpose checks, rather than cash, to pay for certain products and services as well as to pay their taxes. These special purpose checks will be readily accepted and cash will be taken off the streets, mitigating some of the existing public safety risks. Plus, cannabis businesses will have an easier way to pay their state and local taxes. Instead of walking around with suitcases full of cash, taxpayers can simply write a special purpose check.

The bill’s success heavily depends on the number of CLCBs and CLCCUs that form. More institutions mean more access for taxpayers to deposit special purpose checks. If a property owner receives a special purpose check from a cannabis business but does not have an account at

a CLCB or CLCCU, the property owner has little, if any, ability to convert that check to cash, since other banks cannot accept them. Even if the property owner has access to a nearby CLCB or CLCCU, it is unclear how much that property owner 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.

3. Taxes. The author argues that SB 51 will help taxpayers have an easier time paying taxes. However, it is unclear if state agencies would keep an account at one of these banking institutions. State agencies would likely not deposit state money in a bank account that is not insured by the Federal Deposit Insurance Corporation (FDIC). If they did, the agencies would be subjecting state monies to potential federal seizure. State agencies could still accept special purpose checks, but they would have to cash the special purpose check at one of these institutions, and then transport cash to an FDIC insured bank. Local governments will face the same issue. If they choose to keep an account with a cannabis depository institution, they risk subjecting local funds to potential federal seizure. Additionally, a cannabis depository institution would need to be located in or near a local government for them to realistically consider accepting special purposes checks (see Comment # 5). Otherwise, the local governments would have to transport cash farther distances to be able to deposit a special purpose check, and transfer the cash to an FDIC insured bank.

4. Let's get going. The Committee has held three separate hearings on cannabis tax collection and related issues over the past two years: *California Cannabis in a Turbulent Time* on February 14, 2017; *Preparing for California's Green Gold Rush* on July 19, 2017; and *First 60 Days of Prop. 64* on March 1, 2018. The three hearings showed that cannabis issues are complex and tough to solve. While SB 51 contains a delayed implementation date of July 1, 2020, and a requirement for DBO to issue emergency regulations, will the emergency regulations be ready by July 1, 2020? If not, it is unlikely that any businesses will apply to become a cannabis depository institution or choose to keep money within a newly developed institution. The Committee may wish to consider eliminating the requirement to report to the Senate Committee on Banking and Financial Institutions, and the Senate Committee on Governance and Finance to allow DBO to focus on finishing the emergency regulations.

5. Electronic transmissions. Even though SB 51 authorizes different CLCBs and CLCCUs to enter into banking networks with one another, this authority does not extend to electronic transmission of money. Only a change in federal law would grant CLCBs or CLCCUs access to federal payment rails, which allow different banks to transmit money electronically to each other. This access will not be granted as long as cannabis remains illegal at the federal level. As a result, CLCBs and CLCCUs will have to devise ways to accept and deposit checks issued by their brother or sister CLCBs and CLCCUs that do not include federal payment rails.

6. Public safety. Due to the federal status of cannabis and the inability for many cannabis businesses to access bank accounts, the industry is a predominately cash business. Cannabis businesses worry that large amounts of cash on hand make them a target for theft and crime. The Committee may wish to consider adding an urgency clause due to the public safety issues that arise from large amounts of cash that exchange hands on a daily basis.

7. Incoming! On April 3rd, the Senate Committee on Banking and Financial Institutions approved SB 51 by a vote of 6 to 1. The Committee on Governance and Finance is hearing the measure as the committee of second reference.

**Support and Opposition (4/19/19)**

Support: State Treasurer Fiona Ma (sponsor); Aeon Botanika; Begreenlegal; Budberry; Calasian Chamber Of Commerce; California Cannabis Industry Association; California Norml; City of Irvine; City Of Sacramento; City of Santa Monica; Eaze Solutions, Inc.; El Capitan Advisors; Fiona Ma Treasurer; Gallegos Law Firm; Green Believers; Hardcar; La Vida Verde; Loudpack; Lovingly and Legally SPC; Med Men; NCIA; Origin House; Rural County Representatives of California; Rezai, Khorsandi and Lahijani; Sespe Creek; SFCRA; Southern California Coalition; The Artist Tree; Tree House; Undeniable, INC; United Cannabis Business Association; Vanguard Concepts; VCC Brands

Opposition: Siskiyou County Sheriff'S Office, 305 Butte Street, Yreka, Ca 96097

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