

Date of Hearing: July 9, 2019

ASSEMBLY COMMITTEE ON BUSINESS AND PROFESSIONS

Evan Low, Chair

SB 51 (Hertzberg) – As Amended June 13, 2019

SENATE VOTE: 36-1

SUBJECT: Financial institutions: cannabis

SUMMARY: Provides for the licensure and supervision of cannabis limited charter banks and credit unions authorized to offer limited depository services to cannabis businesses. Restricts the activities of cannabis limited charter banks and credit unions to accepting deposits and issuing and redeeming special purpose checks. Prohibits a cannabis limited charter bank or credit union from engaging in banking activity with any other financial institution that lacks a limited purpose charter. Declares that this act is an urgency statute and shall go into effect immediately.

EXISTING LAW:

1. Provides for the licensure and regulation of commercial cannabis activities by various state agencies.
2. Authorizes Department of Business Oversight (DBO) to license and regulate financial institutions, including banks and credit unions (Financial Code Section 99 et seq.).

EXISTING FEDERAL LAW:

1. Classifies cannabis as a Schedule 1 substance under the Controlled Substances Act (21 U.S. Code 812 et seq.) and places regulatory restrictions on research, supply, and access to Schedule 1 substances.
2. Requires financial institutions to report suspected illegal activity to the federal government (31 U.S. Code 5311 et seq.), including activity of suspected cannabis businesses that operate under state law.
3. Provides that all property purchased using proceeds from an illegal activity is subject to forfeiture (18 U.S. Code 1961 et seq.).

THIS BILL:

1. Adds a new division within the Financial Institutions Law (Financial Code Section 99 et seq.) called the Cannabis Limited Charter Banking and Credit Union Law (Financial Code Section 11000 et seq.).
2. Defines “banking services” as the provision of depository services with respect to cash or other funds and the issuance and acceptance of special purpose checks, including the acceptance and maintenance of deposit proceeds, as specified.

3. Defines “cannabis business” as a person licensed by the state of California to engage in commercial cannabis activity under Division 10 of the Business and Professions Code and an ancillary business that serves such a licensed person.
4. Provides for the licensure of a cannabis limited charter bank or credit union (hereafter referred to as a “cannabis depository institution” or “CDI”) by the Department of Business Oversight (DBO) and requires such licensees to comply with all requirements of the Financial Institutions Law, as applicable, except to the extent that any requirement of that law is inconsistent with the provisions of this bill, in which case the provisions of this bill would prevail.
5. Requires a CDI to adopt policies and practices that allow it to achieve the principles and goals outlined in the federal Bank Secrecy Act and cooperate with the federal Financial Crimes Enforcement Network.
6. Authorizes a CDI to accept deposits and issue to an account holder special purpose checks that 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 the account holder’s cannabis business.
 - d. Purchase bonds or similar debt instruments issued by the state or a local agency.
7. Authorizes the state and local agencies to accept special purpose checks.
8. Specifies that no private or public entity is required to accept special purpose checks.
9. Authorizes a CDI to cash a special purpose check presented by a person that is not an account holder if the check was used for an authorized purpose, as specified in #6 above.
10. Requires a CDI to obtain and maintain private insurance for itself and its assets, in an amount acceptable to DBO.
11. Authorizes a CDI to form a banking network with other CDIs to assist each other in providing services to cannabis businesses, subject to the approval of DBO. Prohibits this network from including any institution that is not a CDI.
12. Authorizes a CDI to charge fees for the banking services it provides and requires the CDI to conspicuously post a fee schedule to its website.
13. Prohibits a CDI from engaging in banking activity (this bill does not define this term) with any financial institution that lacks a limited charter.
14. Prohibits a CDI from engaging in any activity beyond those necessary to accept deposits and perform actions expressly authorized by this bill.

15. Creates the Cannabis Limited Charter Bank and Credit Union Advisory Board, comprised of the Treasurer, the Controller, and the Chief of the Bureau of Cannabis Control. Requires DBO to submit annual reports related to enforcement activities and requires the Board to evaluate the reports and make recommendations to the Legislature and Governor.
16. Provides that the division shall become inoperative if either:
 - a. The federal government remove cannabis from the schedule of controlled substances, or
 - b. The federal government enacts legislation that establishes protections for depository institutions that provide financial services to cannabis-related legitimate businesses.
17. Within thirty days of a triggering event as described immediately above in #16, requires DBO to provide guidance for orderly resolution of all CDIs, as specified. A CDI would have up to one year to resolve in a manner acceptable to state and federal regulators.
18. Makes findings and declarations related to the history of cannabis legalization in California, federal policy related to cannabis, and the need for banking services in the cannabis industry.
19. Declares that in order to eliminate public safety issues presented with managing and transporting cash because of the lack of access to financial services for cannabis businesses, to enable state and local governments to accurately perform accounting and other regulatory functions over the cannabis industry, and to enable cannabis businesses to comply with laws regulating the cannabis industry, it is necessary that this bill take effect immediately.

FISCAL EFFECT: Unknown. This bill is keyed fiscal by Legislative Counsel.

COMMENTS:

Purpose. This bill is sponsored by Treasurer Fiona Ma. According to the Author, “Despite its legal status in California, cannabis’ federal classification as a Schedule I drug prohibits cannabis-related businesses from depositing income with federally-insured financial institutions. 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 – businesses face security risks because of the volume of cash in their possession. Further, the Department of Finance estimates that tax receipts will only continue to grow in the coming years, and it is unacceptable for cannabis businesses to have to continue arriving to government offices with duffel bags of cash to fulfill their tax obligations.”

Background. Federal law prevents some cannabis businesses from accessing financial services provided by banks and credit unions, including basic checking accounts and electronic payment services that nearly all business rely to facilitate transactions with their customers. As briefly explained in the Existing Federal Law section above, federal law categorizes cannabis as a controlled substance and prohibits the possession and distribution thereof. Additionally, federal law places requirements on financial institutions to deter money laundering through reporting of

suspected illegal activity, which includes commercial activities related to cannabis.¹ Federal law enforcement agencies, such as the Department of Justice, and federal regulators, including the Federal Reserve, National Credit Union Administration, and Federal Deposit Insurance Corp, have discretion in how these laws are implemented and enforced. Federal guidelines have provided comfort to several hundred banks and credit unions across the country to serve the cannabis industry; however, these financial institutions are doing so at their own risk of negative regulatory action and criminal prosecution.

Although some banks and credit unions accept the elevated legal risk and compliance costs to serve some cannabis businesses, some licensed cannabis businesses in California do not have access to banking services. According to a survey conducted by the California Growers Association in 2017, more than two-thirds of its membership is unbanked, with cultivators having the lowest level of access along the supply chain. Unbanked cannabis businesses transact primarily in cash, which makes the businesses and surrounding community targets for violent criminal activity. Cash businesses also present challenges to state and local tax collection and enforcement efforts.

This bill envisions a partial solution to the cannabis banking problem through the creation of cannabis limited charter banks and credit unions (hereafter referred to as “cannabis depository institution” or “CDI”). Upon approval by the Department of Business Oversight (DBO) of a charter application, a CDI would be authorized to provide a very limited selection of services to its customers: the acceptance of deposits and the issuance and redemption of special purpose checks. These special purpose checks are limited to four general uses: 1) the payment of fees and taxes to local and state government agencies, 2) the payment of rent on property leased by, or on behalf of, a cannabis business, 3) payments to vendors physically located in California for expenses related to goods and services associated with the cannabis business, and 4) the purchase of bonds or similar debt instruments issued by the state or specified local agencies. CDIs are also authorized to form a network exclusively with other CDIs to assist each other in providing services to cannabis businesses.

Under this bill, CDIs are prohibited from engaging in most banking activities. This bill prohibits CDIs from offering common banking services, such as:

- merchant accounts that allow businesses to accept electronic payments (e.g., debit and credit cards);
- processing Automated Clearing House (ACH), Fedwire, or other electronic payment transactions that rely on networks that include any non-CDI financial institutions; and
- making, offering, brokering, or servicing loans.

In order to meet the needs of the cannabis industry, a substantial number of CDI branches will be necessary. Given the prohibitions against processing electronic payments and funds transfers, CDI branches must be in reasonable physical proximity to users of CDIs. Account holders will need access to a nearby branch in order to make regular cash deposits that significantly reduce the incentive for theft and robbery at their premises. Furthermore, CDI branches must be

¹ The Bank Secrecy Act as amended by the USA Patriot Act (31 U.S. Code 5311 et seq.)

conveniently located and widely accessible to entice potential payees of special purpose checks to voluntarily agree to accept such checks.

Prior Related Legislation. SB 930 (Hertzberg, 2018), substantially similar to this bill, would have authorized the creation of cannabis limited charter banks and credit unions and authorized the use of special purpose checks issued by those institutions for specified purposes. The measure was held in the Assembly Appropriations Committee.

ARGUMENTS IN SUPPORT:

California Cannabis Manufacturer Association writes in support, “SB 51 creates a limited purpose state charter bank license that would be administered and regulated by the Department of Business Oversight. Privately-funded banks that receive this charter would be able to provide limited banking and custodial services to licensed cannabis and cannabis-related businesses. Under SB 51, banks could issue checks to accountholders to be used for the following purposes:

- Pay state and local taxes and fees,
- Pay vendors from California for goods and services provided to the cannabis business,
- Pay rent, and
- Purchase state and local bonds and other debt instruments.”

In addition, *Eaze Solutions, Inc.* states, “The passage of Proposition 64 legalized cannabis in California in 2016. However, due to incongruity in state and federal law there are many challenges for the industry – none more dangerous than the lack of access to traditional financial institutions. Many banks refuse to provide services to state sanctioned cannabis business due to the risk of criminal or civil liability under federal drug and banking laws. This leaves many cannabis businesses unable to operate in a normal business fashion using checks, credit cards, or electronic transfers, and forces them to transact in all cash creating serious public safety concerns for everyone involved. Large amounts of cash can make cannabis businesses, their employees, and their customers targets of violent crime. Furthermore, state and local government agencies that collect tax and fee payments in cash from the cannabis industry incur added expenses, demands on staff time, and risks to employee safety.”

ARGUMENTS IN OPPOSITION:

Eagle Forum of California argues, “Cannabis is still listed as a schedule I drug by the Federal Government. Related cost could be unnecessary and premature if The Federal “States Act” passes Congress. Subsidizes an “addiction-based industry” using tax payer dollars. Estimated it could cost approximately \$2 million per year for the Department of Business Oversight (DBO) for the chartering of new banks and credit unions. There are unknown potentially significant costs to the State Treasurer’s Office, the State Controller’s Office, the Bureau of Cannabis Control, and the Department of Finance. CA should not be favoring and accommodating one industry over another which this bill clearly does.”

POLICY ISSUES:

There is a slight lack of clarity in this bill in regards to of the challenges mentioned and outlined in the Assembly Committee on Banking and Finance, June 24, 2019 Analysis. These challenges can be partially resolved through rulemaking and supervision by DBO. Strong state oversight

reduces the risk that unscrupulous actors would be able to establish a CDI to defraud or prey on cannabis businesses that are desperate for a banking solution. DBO uses a rigorous set of criteria when reviewing an applicant for a bank or credit union charter, and the department will heavily scrutinize an applicant's private insurer to verify that the insurance policy will be available to compensate depositors if the CDI encounters financial troubles.

REGISTERED SUPPORT:

State Treasurer Fiona Ma (Sponsor)
Aeon Botanika
Alameda; City Of
BeGreenLegal
Black American Political Association of California
Budberry
Calasian Chamber Of Commerce
California Cannabis Industry Association
California Cannabis Manufacturers Association
California Chapter of the National Organization for the Reform of Marijuana Laws
California State Treasurer
City of Alameda
City of Irvine
City of Sacramento
City of Santa Monica
County of Los Angeles Board of Supervisors
Eaze Solutions, Inc.
El Capitan Advisors
Gallegos Law Firm
Green Believers
Hard Car Security
La Vida Verde
Los Angeles County Board of Supervisors
Loudpack
Lovingly and Legally
MMMG LLC. dba Medmen
National Cannabis Industry Association
Origin House
Rezai Khorsandi & Lahijani ALC
Rural County Representatives of California
San Francisco Cannabis Retailers Alliance
Santa Monica; City Of
Sespe Creek Collective
Southern California Coalition
The Artist Tree
TreeHouse
Undeniable INC
United Cannabis Business Association

Vanguard Concepts, LLC
VCC Brands

REGISTERED OPPOSITION:

Alliance Financial Network Inc.
Eagle Forum of California
Siskiyou County Sheriff's Office

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