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Unlock the Cannabis Industry for Financial Institutions

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April 19, 2023

Around the country, people are gearing up to celebrate all things cannabis on 4/20, but banks and other financial institutions are unlikely to have the occasion marked on their calendars. Despite states continuing to legalize cannabis, federal law has remained unchanged, and that means federally regulated financial institutions must keep their distance.

To be clear, financial institutions are legally allowed to do business with the cannabis industry. The catch, however, is that they must deal with a dizzying array of regulatory requirements that often deter them from working with cannabis businesses.

This "regulatory distancing" is not unique to cannabis: Cumbersome regulatory requirements have also been a driving force behind financial institutions leaving the southern border and the Caribbean. As Rep. Patrick McHenry (R–N.C.) noted at a congressional hearing on banking with the Caribbean last year, the problem is the penalty for failing to comply with anti-money laundering regulations "can be so devastating for financial institutions, especially small and medium-sized banks, that they turn to defensive approaches to ensure compliance." One of these defensive approaches is to avoid "risky" markets entirely.

McHenry is right, but it's not just the penalties that are devastating. Complying with the Bank Secrecy Act—the law responsible for much of this financial surveillance regime—cost financial institutions in the United States an estimated $45.9 billion in 2022.

As troubling as these costs may be in general, serving the cannabis industry is another matter entirely. In addition to all of the usual compliance costs associated with the Bank Secrecy Act, the Financial Crimes Enforcement Network (FinCEN) has instructed financial institutions to not just verify that cannabis businesses are licensed by the state, but also review their applications and related documentation to make sure the state did not make a mistake. Going further, the financial institution then needs to request all the information held by the state to cross-check the business again. Once everything is in order and the business gains access to an account, FinCEN then says financial institutions need to maintain ongoing monitoring of each businesses' activity, what they sell, who their customers are, and possible sources for adverse information.

In other words, bank employees are required to act as detectives on behalf of the federal government.

Yet the most egregious part of this story might not be that legal businesses have been kept out of the financial system, that tens of billions of dollars are spent in compliance, or that the financial industry has been deputized as law enforcement investigators.

The most egregious part is that all of that has occurred, and yet, there's no sign criminals are actually being stopped in the process.

FinCEN has been asked for years to offer aggregate statistics regarding the effectiveness of this reporting regime. Yet time and time again, requests have come up empty. Even a mandate from Congress hasn't been enough to make these numbers available.

However, past studies have offered some insights. A 2018 Bank Policy Institute study found only 3.65 percent of suspicious activity reports (SARs) and 0.44 percent of currency transaction reports (CTRs) required some form of follow-up by law enforcement.

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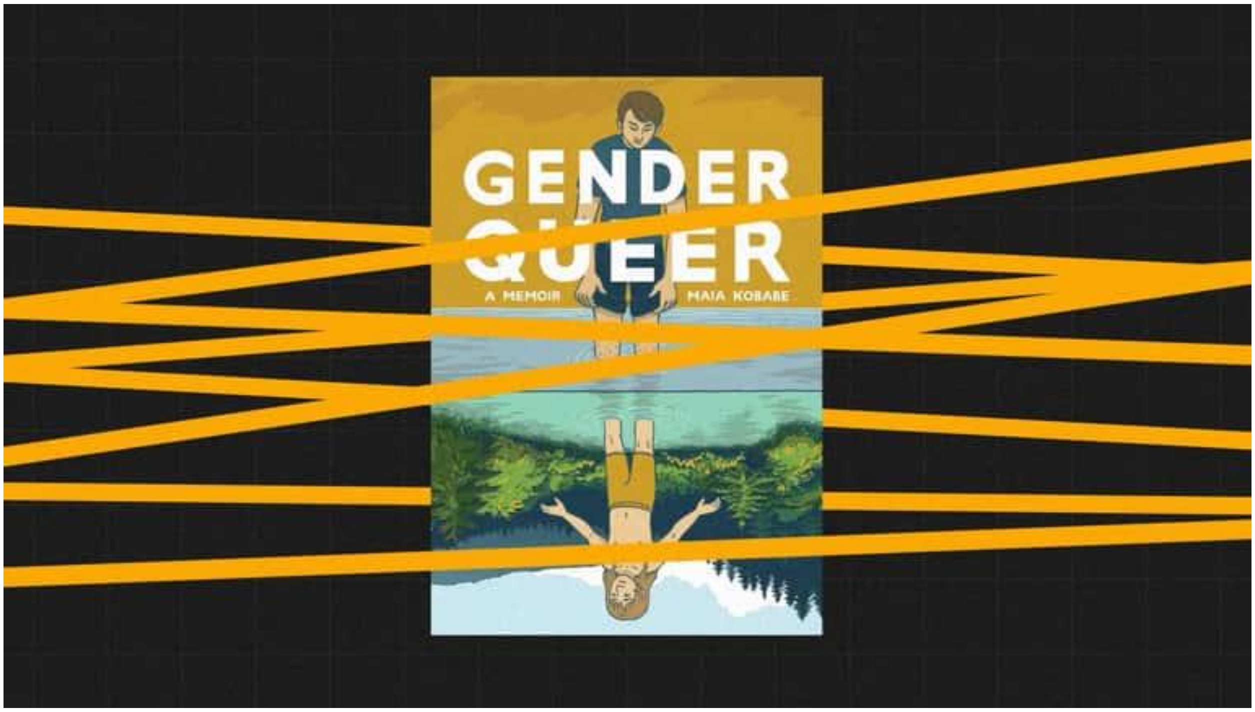

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In short, financial institutions have been locked out of the cannabis industry because of a surveillance regime that appears to have done little to stop real criminals. The law has only seemed to succeed in targeting CEOs of cannabis companies, storefront employees, and consultants. Even politicians have been caught in the crosshairs after campaign contributions from the cannabis industry marked Florida's agriculture commissioner as too risky.

Something needs to change.

From federal legalization to regulatory carve-outs, there is much to choose from in terms of taking steps forward toward a better financial system. Aaron Klein, a senior fellow at the Brookings Institution, has explained that the Treasury could exempt financial institutions from reporting state-licensed marijuana businesses. Given that the Treasury set the rules of the road after the initial passage of the Bank Secrecy Act, it would be all too fitting to have it fix the potholes.

However, Congress has a role to play as well. To fix the problem for the long term (and for everyone), Congress should repeal the Bank Secrecy Act—or at least, repeal the sections that have required financial institutions to constantly report customers to the federal government.

Taken together, these strategies would ensure that bankers are able to take part in the festivities next year and for many years to come. Between the cannabis industry gaining access to financial services, the banking industry saving billions in compliance costs, and

Americans having their financial privacy restored, it's safe to say everyone will have something to celebrate.

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