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### WHY U.S. STATES NEED THEIR OWN CANNABIS INDUSTRY BANKS

CHRISTOPH HENKEL\* & RANDALL K. JOHNSON\*\*

#### ABSTRACT

*The legal cannabis trade is the fastest growing industry in the United States. In 2019, about 48.2 million Americans used the drug at least once.<sup>1</sup> As such, it is easy to see why the legal cannabis trade may generate annual revenues exceeding \$30 billion in Fiscal Year 2022 alone.<sup>2</sup>*

*One inconvenient truth, however, is that the parties to any cannabis trade may face a range of difficulties due to conflicts between federal and state laws.<sup>3</sup> These difficulties include the fact that many financial institutions are reluctant to handle cannabis proceeds. One reason is that a*

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1. See *Marijuana and Public Health, Data and Statistics*, CTRS. FOR DISEASE CONTROL & PREVENTION (June 8, 2021), <https://www.cdc.gov/marijuana/data-statistics.htm> [<https://perma.cc/E34J-GXKZ>].

2. See *Report: U.S. Cannabis Sales Could Exceed \$30 Billion by 2022*, BURNS & WILCOX (Aug. 4, 2021), <https://www.burnsandwilcox.com/insights/report-u-s-cannabis-sales-could-exceed-30-billion-by-2022/#:~:text=Legal%20cannabis%20sales%20in%20the%20U.S.%20could%20exceed,reachin%20%2428%20billion%20in%20yearly%20sales%20by%202022> [<https://perma.cc/J5SP-XC3X>] (explaining that “[l]egal cannabis sales in the U.S. could exceed \$30 billion by 2022”).

3. See Legal Info. Inst., *Conflict of Laws*, CORNELL L. SCH. (Aug. 2022), [https://www.law.cornell.edu/wex/conflict\\_of\\_laws#:~:text=Conflict%20of%20laws%20refers%20to,resolve%20each%20issue%20in%20dispute](https://www.law.cornell.edu/wex/conflict_of_laws#:~:text=Conflict%20of%20laws%20refers%20to,resolve%20each%20issue%20in%20dispute) [<https://perma.cc/VPD3-BHHJ>] (defining the term to mean that “[c]onflict of laws refers to a difference between the laws of two or more jurisdictions with some connection to a case, such that the outcome depends on which jurisdiction’s law will be used to resolve each issue in dispute. The conflicting legal rules may come from U.S. federal law, the laws of U.S. states, or the laws of other countries.”).

*lack of alignment in terms of federal and state laws, at least when compared to otherwise similarly situated U.S. infant industries, drives up the cost of doing business in sub-national cannabis industries.*<sup>4</sup>

*As a result, states that purport to authorize cannabis trades may need to intervene. The simplest way to do so, and thereby increase access to financial services in this infant industry, is by creating a new state-owned cannabis industry bank. Such a bank may be created, insofar as it would be possible, exclusively under state laws to avoid any actual conflict with federal cannabis laws.*

*There also are three additional reasons why states may want to create their own cannabis industry banks. First, each state is responsible for the creation of their own in-state cannabis industry and should receive the lion-share of future economic benefits that arise from the legal cannabis trade. Second, these sub-national jurisdictions incurred significant costs in creating these infant industries and are justified in receiving a robust return on their past investments. The final reason is states could use any such return on investment to compensate third parties that are harmed by the legal cannabis trade, at least in cases when their injury arises from lawful activities, such as African Americans who are disproportionately subjected to pretextual stops by law enforcement.*<sup>5</sup>

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4. See *Infant Industry*, CAMBRIDGE DICTIONARY (2023), <https://dictionary.cambridge.org/us/dictionary/english/infant-industry> [<https://perma.cc/54SQ-K2FN>] (defining the term to mean “a new industry that is in its earliest stage of development”).

5. Ross Douthat, Opinion, *Legalizing Marijuana Is a Big Mistake*, N.Y. TIMES (May 17, 2023), <https://www.nytimes.com/2023/05/17/opinion/marijuana-legalization-disaster.html> [<https://perma.cc/532V-DYCP>] (“[T]here is . . . no good evidence so far that legalization reduces racially discriminatory patterns of policing and arrests. . . . [In fact, a recent study asserts that] . . . cops often use marijuana as a pretext to search someone they suspect of a more serious crime, and they simply substitute some other pretext when the law changes, leaving arrest rates basically unchanged.”). One way to provide compensation is through the provision of free bank accounts, grant funding, and direct lending in areas where racially discriminatory patterns of policing and arrests frequently occur.

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## INTRODUCTION

In every state that purports to authorize the lawful sale of cannabis,<sup>6</sup> which continues to be classified as an illegal substance at the federal level, there are sub-national regulations that need to be complied with by cannabis industry participants.<sup>7</sup> With respect to buyers and sellers, at least in jurisdictions that do not authorize the unfettered trade of cannabis, “[o]nly an individual (or entity) holding a state-issued permit may engage in [regulated] activities.”<sup>8</sup> These regulated activities, for purposes of this essay, are any acts that take place within a U.S. jurisdiction in support of “the growth, testing, manufacture, distribution and sales of cannabis.”<sup>9</sup>

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6. It must be noted, however, that the legal basis for state authorization may not be founded on solid ground. Cf. Robert A. Mikos, *On the Limits of Supremacy: Medical Marijuana and the States’ Overlooked Power to Legalize Federal Crime*, 62 VAND. L. REV. 1421, 1422–23 (2009) (explaining that “[i]n *Gonzalez v. Raich*, [545 U.S. 1 (2005), the U.S.] Supreme Court affirmed Congress’s power to enact [a] ban [on certain trades in medical cannabis]. In fact, it suggested that Congress’s power to regulate, and hence to proscribe, medical [cannabis] (among other things) was almost unlimited.” (footnotes omitted)).

7. See Jonathan G. Blattmachr, Bridget J. Crawford & Mitchell M. Gans, *Estate and Gift Tax Valuation of Cannabis Business Interests*, 161 TRS. & ESTS. 22, 23 (2022).

8. *Id.*

9. *Id.*

Examples of these regulated activities include banking and/or other financial services, which are carried out by third parties.<sup>10</sup>

Despite an increasing number of states that seek to immunize cannabis industry licensees from certain types of legal liability, usually by expressly authorizing in-state trading of this federal contraband, it must be noted that any such immunity does not provide a federal-level defense nor does it authorize inter-state cannabis trades between states that purport to authorize such commercial transactions.<sup>11</sup> In other words, cannabis “remains illegal under [federal laws and regulations such as] the Controlled Substances Act (CSA), regardless of the reason for its use.”<sup>12</sup>

Among the legal consequences of this conflict of laws is that many financial institutions refuse to be involved with cannabis industry transactions at all.<sup>13</sup> And the financial institutions that choose to do so charge substantial premiums.<sup>14</sup> The few thrifts, banks, and credit unions that charge substantial premiums justify them as the cost of complying with U.S. cannabis regulations.

Within this context, there are good arguments for more states to create their own cannabis industry banks.<sup>15</sup> There are, at least, three reasons why these limited subject matter banks are the single best way to provide cannabis businesses with greater access to additional financial services. First, each state is responsible for the creation of their own in-state cannabis industry and should receive the lion-share of future economic benefits that arise from the legal cannabis trade.<sup>16</sup> Second, these sub-national

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10. *Id.*

11. See Lewis A. Grossman, *Life, Liberty, [and the Pursuit of Happiness]: Medical Marijuana Regulation in Historical Context*, 74 FOOD & DRUG L.J. 280, 288 (2019). Any purported immunity would protect regulated parties from legal liability that arises from the in-state production, possession, transportation, and sale of cannabis. See, e.g., Emily Laurence & Alena Hall, *Your Guide to Cannabis Legalization by State*, FORBES HEALTH (Aug. 1, 2023, 8:30 AM), <https://www.forbes.com/health/body/cannabis-legalization-by-state/> [<https://perma.cc/C78T-2488>] (providing a list of states that did so).

12. Grossman, *supra* note 11, at 309.

13. See, e.g., Jessica Bartlett, ‘Cannabis Premium’: If You Want to Bank Marijuana Money, It’ll Cost You, BOS. BUS. J. (June 27, 2018), <https://www.bizjournals.com/boston/news/2018/06/27/cannabis-premium-if-you-want-to-bank-marijuana.html> [<https://perma.cc/B8NH-5LAU>] (noting that “[t]he only bank in Massachusetts working in medical marijuana is charging businesses \$5,000 a month for a checking account”).

14. *Id.*

15. Cf. ANDREW P. SCOTT, CONG. RSCH. SERV., R47014, AN ANALYSIS OF BANK CHARTERS AND SELECTED POLICY ISSUES 19 (2022) (explaining that, especially in recent years, various state governments have “explored the possibility of granting special purpose charters to . . . companies that may seek to engage in bank-like activities, such as lending, payment processing, and [other related financial] services”).

16. One example of the costs incurred in creating an ostensibly legal cannabis industry is the money that U.S. states spend on sub-national ballot initiatives. *Compare Ballot Measures Cost Per Required Signatures Analysis*, BALLOTPEdia, [https://ballotpedia.org/Ballot\\_measures\\_cost\\_per\\_required\\_signatures\\_analysis](https://ballotpedia.org/Ballot_measures_cost_per_required_signatures_analysis) [<https://perma.cc/7TVB-XELP>] (describing the average administrative

jurisdictions incurred significant costs in creating these infant industries and are justified in receiving a robust return on their past investments.<sup>17</sup> Finally, states could use any such return on investment to compensate third parties that are harmed by the legal cannabis trade, at least in cases when their injury arises from lawful activities, such as African Americans who are disproportionately subjected to bad-faith (pretextual) stops by police officers.<sup>18</sup>

This essay proceeds in four additional parts. First, Part I describes the current state of the law and its negative impacts on the legal cannabis industry. Part II describes how U.S. governments have tried to limit these negative impacts through legislative action. Part III shows how governments may do even more by creating their own financial institutions to meet the needs of the cannabis industry. Part IV concludes with a summary and details about how states may protect their investment in cannabis industry banks. For the purposes of this essay, we assume cannabis is lawful under applicable state laws: despite compelling arguments to the contrary.<sup>19</sup>

## I. ISSUE PRESENTED

The fact that cannabis remains a Schedule One illegal drug under federal law, but is considered legal under the law of an increasingly large number of states, has implications for the dual sovereign system in the United States.<sup>20</sup> And, due to the fact that it is unclear whether federal or state law has supremacy in certain contexts, this conflict of laws limits the legal

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cost of state referendum in recent fiscal years), with *Missouri Changes to Medical Marijuana Program Initiative (2022)*, BALLOTPEdia, [https://ballotpedia.org/Missouri\\_Changes\\_to\\_Medical\\_Marijuana\\_Program\\_Initiative\\_\(2022\)](https://ballotpedia.org/Missouri_Changes_to_Medical_Marijuana_Program_Initiative_(2022)) [https://perma.cc/H5JV-CJKE] (describing one recent example of a referendum). Another, perhaps overlooked, example is government failures that arise from overly forgiving state policies and procedures. See Adam Schuster, *Illinois 'Half-Baked' Marijuana Legalization Costs State \$600M*, ILL. POL'Y INST. (Apr. 20, 2022), <https://www.illinoispolicy.org/illinois-half-baked-marijuana-legalization-costs-state-600m/> [https://perma.cc/T4E9-NK68] (“Two years into Illinois’ experiment with legalized recreational marijuana, high taxes and restrictive licensing have let \$600 million in potential revenue go up in smoke, as well as failed to snuff out the illegal market as proponents had hoped.”); see, e.g., Clifford Winston, *Government Failure vs. Market Failure: Microeconomics Policy Research and Government Performance*, BROOKINGS (Sept. 1, 2006), <https://www.brookings.edu/articles/government-failure-vs-market-failure-microeconomics-policy-research-and-government-performance/> [https://perma.cc/48N6-X5DT].

17. See Schuster, *supra* note 16.

18. See, e.g., *People v. Sinclair*, 194 N.W.2d 878 (Mich. 1972) (discussing the broad political implication of marijuana possession and criminalization in Michigan).

19. See Mikos, *supra* note 6.

20. See generally *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 406 (1819) (noting that “the 10th amendment . . . was framed for the purpose of quieting the excessive jealousies” between the U.S. federal government and state governments, especially with respect to the ability of each sovereign to regulate or establish a thrift, “bank or . . . corporation”).

cannabis industry's profitability, stability, and future prospects in a number of different U.S. institutional settings.<sup>21</sup>

For example, federally regulated banks may be prohibited from handling the proceeds from state-authorized cannabis trades, regardless of whether such transactions are considered to be legal under state law.<sup>22</sup> In other words, the conflict between state and federal law creates a situation in which the proceeds from legal state cannabis trades are handled differently than proceeds from otherwise similarly situated trades that are not federally prohibited, such as the sale or purchase of alcohol, nicotine, and other disfavored products.<sup>23</sup> One result is increased uncertainty, as it may be difficult to predict how cannabis trades will be treated, which increases their transaction costs.<sup>24</sup>

The federal government also could prosecute any legal persons that are involved in a transaction involving cannabis. And, in doing so, set the stage to confiscate the proceeds from any such deal.<sup>25</sup> As such, financial institutions that handle the proceeds of cannabis trades are exposed to criminal or civil liability under federal law.<sup>26</sup> Although enforcement actions

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21. See, e.g., Amy J. Kellogg, Caitlin A. Anderson & Meg C. Michiels, *A Cannabis Conflict of Law: Federal vs. State Law*, AM. BAR ASS'N BUS. L. TODAY (Mar. 21, 2022), <https://businesslawtoday.org/2022/03/cannabis-conflict-federal-vs-state-law/#:~:text=This%20article%20will%20explore%20how%20the%20conflict%20of,bankers%20must%20make%20without%20clear%20guidance%20and%20direction> [<https://perma.cc/Q677-AJXE>] (explaining that “the conflict of law between the narrow federal landscape and the expansion of state cannabis laws has created numerous business law complications, including its impact on the banking rules and regulations”).

22. See, e.g., Julie Andersen Hill, *Banks, Marijuana, and Federalism*, 65 CASE W. RES. L. REV. 597 (2015). Maybe most importantly, this conflict also challenges the so-called dual banking system which remains the basis for the banking system in the United States today. Under the dual banking system, the states and the federal government share bank chartering authority. National banks are chartered and supervised by the Office of the Comptroller of the Currency (OCC) while state banks are chartered by state regulators. The dual banking system and the option for state banks to elect to become national banks following the National Banking Act of 1863 and 1864 was the result of political differences over slavery and the need to find new revenue streams to finance the Civil War. See, e.g., HOWARD BODENHORN, *STATE BANKING IN EARLY AMERICA: A NEW ECONOMIC HISTORY* 40–41 (2002); BRAY HAMMOND, *BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR* 713 (1991); see also JAMES WILLARD HURST, *A LEGAL HISTORY OF MONEY IN THE UNITED STATES, 1774-1970* (1973); RON CHERNOW, *ALEXANDER HAMILTON* 6 (2004) (noting that Hamilton argued for a central bank and an advanced financial system).

23. See, e.g., *Fourth Corner Credit Union v. Fed. Rsrv. Bank of Kan. City*, 154 F. Supp. 3d 1185, 1189 (D. Colo. 2016) (highlighting the risk depository institutions face when providing banking services to cannabis-related businesses—denial of the application of a master account with the Federal Reserve in Kansas City).

24. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 15.1, at 533 (9th ed. 2014) (“Transaction costs [are] the costs involved in organizing economic activity through voluntary exchange.”).

25. See, e.g., LEVEL 4 VENTURES, JADE COMPLIANCE SOLS. & RLR MGMT. CONSULTING INC., *STATE-BACKED FINANCIAL INSTITUTION (PUBLIC BANK) FOR THE STATE OF CALIFORNIA SERVICING THE CANNABIS INDUSTRY FEASIBILITY STUDY 2018*, at 8–10 (2018), <https://www.treasurer.ca.gov/comm-external-urls/cannabis-feasibility-full-report.pdf> [<https://perma.cc/F3UL-JFRS>].

26. See, e.g., Hill, *supra* note 22, at 599.

are rarely taken, the mere existence of this risk leads some to avoid working with any cannabis industry business.<sup>27</sup>

Financial institutions that do serve the cannabis industry, perhaps reasonably, charge a premium, thereby insuring against losses within this uncertain regulatory environment. Additional fees also may be imposed by financial institutions that undertake this work, as a way to offset the costs of complying with the Bank Secrecy Act<sup>28</sup> and filing Suspicious Activity Reports (SARs).<sup>29</sup>

So, despite numerous state laws that authorize cannabis trades, most participants in this U.S. infant industry face higher-than-average transaction costs due to conflicts between federal and sub-national laws.<sup>30</sup> One way to reduce these higher-than-average costs is to create limited subject matter banks, which arise solely under the law of a single sub-national jurisdiction.<sup>31</sup> These cannabis industry banks help to avoid actual conflicts between federal and state cannabis laws.<sup>32</sup>

## II. PAST REFORM EFFORTS

Several recent presidential administrations have considered reforms that would limit the uncertainty that is faced by the cannabis industry.<sup>33</sup> Many of these options sought to limit federal interference with state-authorized cannabis trades.<sup>34</sup> But only a few of these reforms were ever taken up in any meaningful way. And an even smaller number of them proved to be successful.

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27. See, e.g., John Hudak & Aaron Klein, *Banks Don't Want to Work with Marijuana Companies. It's Time for that to Change*, CNN BUS. (Mar. 14, 2019), <https://www.cnn.com/2019/03/14/perspectives/cannabis-businesses-banking/index.html> [<https://perma.cc/4ZG6-UMQZ>] (noting that “[s]ince cannabis remains illegal under federal law – and the federal government oversees all US banks and credit unions – banks are often skittish about granting bank accounts to these businesses”).

28. See *The Bank Secrecy Act*, FIN. CRIMES ENF'T NETWORK, <https://www.fincen.gov/resources/statutes-and-regulations/bank-secrecy-act> [<https://perma.cc/SK6N-PMV2>] (describing anti-money laundering reporting requirements); Bank Secrecy Act, 31 U.S.C. § 5311–5336.

29. See *Suspicious Activity Reports (SAR)*, OFF. COMPTROLLER CURRENCY, <https://www.occ.treas.gov/topics/supervision-and-examination/bank-operations/financial-crime/suspicious-activity-reports/index-suspicious-activity-reports.html> [<https://perma.cc/IE4B-56G3>] (defining the different types of Suspicious Activity Reports).

30. See *Fourth Corner Credit Union v. Fed. Rsrv. Bank of Kan. City*, 154 F. Supp. 3d 1185, 1189 (D. Colo. 2016).

31. See SCOTT, *supra* note 15, at 16 (explaining that “states offer charters for trust companies or specialty banks to provide trust services without necessarily offering core commercial bank services”).

32. See *Constitution Annotated, Art.VI.C2.1 Overview of Supremacy Clause*, [https://constitution.congress.gov/browse/essay/artVI-C2-1/ALDE\\_00013395/](https://constitution.congress.gov/browse/essay/artVI-C2-1/ALDE_00013395/) [<https://perma.cc/D8JR-DKDQ>] (describing the U.S. legal system’s “presumption against preemption, under which federal law does not displace state law unless that was the clear and manifest purpose of Congress.” (citation omitted)).

33. See, e.g., Emmette S. Redford, *Dual Banking: A Case Study in Federalism*, 31 LAW & CONTEMP. PROBS. 749, 755–56 (1966).

34. See generally Kellogg, Anderson & Michiels, *supra* note 21.



In the following sections, this essay outlines the universe of reforms that were considered by the federal government. Subsequent sections identify a subset of the many proposals that were put forward by states. These sub-national reform options are representative, rather than exhaustive.

### A. *Invalid Federal Solutions*

One example of an invalid federal solution is the Obama administration's recent decision to issue a series of administrative pronouncements about cannabis.<sup>35</sup> These pronouncements limited federal regulation of certain state-authorized cannabis trades and applied to cases wherein no federal rights are implicated by a state's exercise of its own inherent authority.<sup>36</sup> Each limitation was conveyed through recent Department of Justice (DOJ) Guidance.

#### 1. *Department of Justice (DOJ) Guidance*

During the Obama Administration, the Department of Justice (DOJ) responded to the increasing number of states that legalized cannabis trades by issuing two important pronouncements in 2013 and 2014.<sup>37</sup> These pronouncements came to be known as the first and second Cole Memorandums.<sup>38</sup> Each memorandum explains when, and under what circumstances, the DOJ will prosecute the parties to a state cannabis trade under the Controlled Substances Act.<sup>39</sup>

According to the express language in the First Cole Memorandum, the federal government would limit its efforts to: (1) preventing the distribution of cannabis to minors; (2) preventing revenue and proceeds from the sale of cannabis from being used by criminal enterprises; (3) preventing the transportation of cannabis from states where it is legal to ones where it is not; (4) preventing the sale of cannabis products from being used as cover

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35. It is noteworthy that in early 2018, the Trump administration and its Attorney General Sessions reversed course and rescinded some of the Obama administration's guidance. In particular, DOJ replaced the so-called Cole Memorandum with a new memorandum, permitting U.S. Attorneys to again prioritize enforcement of the Controlled Substances Act. See JEFF B. SESSIONS, OFF. OF THE ATT'Y GEN., MEMORANDUM FOR ALL UNITED STATES ATTORNEYS: MARIJUANA ENFORCEMENT (Jan. 4, 2018) (noting that previous nationwide guidance specific to cannabis enforcement is unnecessary and rescinded, effective immediately).

36. *Id.*

37. *Id.*

38. See JAMES M. COLE, U.S. DEP'T OF JUST., OFF. OF THE DEPUTY ATT'Y GEN., MEMORANDUM FOR ALL UNITED STATES ATTORNEYS: GUIDANCE REGARDING MARIJUANA ENFORCEMENT (Aug. 29, 2013) [hereinafter First Cole Memorandum]; JAMES M. COLE, U.S. DEP'T OF JUST., OFF. OF THE DEPUTY ATT'Y GEN., MEMORANDUM FOR ALL UNITED STATES ATTORNEYS: GUIDANCE REGARDING MARIJUANA RELATED FINANCIAL CRIMES (Feb. 14, 2014) [hereinafter Second Cole Memorandum].

39. *The Controlled Substances Act*, U.S. DRUG ENF'T AGENCY, <https://www.dea.gov/drug-information/csa> [https://perma.cc/48V4-WDDR] (defining cannabis as an illegal substance).

for illegal activity; (5) preventing the use of firearms in the cultivation or distribution of cannabis; (6) preventing cannabis trades from encouraging behavior that does not have any societal benefit such as drunk driving; (7) preventing the production of cannabis on public lands; and (8) preventing cannabis use on federal property.<sup>40</sup> This pronouncement left unanswered whether other state-authorized cannabis activities, which were not referenced in this guidance, may give rise to federal-level sanctions.<sup>41</sup>

In order to reduce the risk of federal sanctions, the First Cole Memorandum called for state and local governments to implement “strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale, and possession of [cannabis].”<sup>42</sup> This pronouncement also urged states to put into place more “effective measures to prevent diversion of [cannabis] outside of the regulated system and to other states, prohibiting access to [cannabis] by minors, and replacing an illicit trade that funds criminal enterprises with a tightly regulated market in which *revenues are tracked and accounted for*.”<sup>43</sup> By describing what constitutes prohibited behavior, in detail, the First Cole Memorandum hoped to reduce the uncertainty faced by cannabis businesses.<sup>44</sup>

After the release of the First Cole Memorandum, additional administrative guidance was provided in February 2014.<sup>45</sup> This follow-up work, which is called the Second Cole Memorandum, expressly stated that the pronouncement “[was] intended solely as a guide to the exercise of investigative and prosecutorial discretion.”<sup>46</sup> And unlike the First Cole Memorandum, this guidance attempted to more clearly explain how prosecutors determine whether one has run afoul of applicable federal laws.<sup>47</sup>

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40. First Cole Memorandum, *supra* note 38.

41. One example of other state-authorized activities, which were not referenced in the guidance, includes third-party delivery of cannabis and its derivatives. *See, e.g.*, H.B. 23-1020, 2023 Reg. Sess. (Colo. 2023) (describing social equity delivery permits).

42. First Cole Memorandum, *supra* note 38; *The Controlled Substances Act*, *supra* note 39.

43. First Cole Memorandum, *supra* note 38 (emphasis added). The focus on tracking and accounting seems noteworthy and even contradictory, because access to financial services is essential to accomplish this goal. The reliance on cash, as most cannabis businesses do, accomplishes the direct opposite result. And, rather than being helpful, creates danger, attracts crime, and makes it almost impossible to track or account for revenue and profits of these businesses. *See, e.g.*, JOHN CHIANG, BANKING ACCESS STRATEGIES FOR CANNABIS-RELATED BUSINESSES: A REPORT FROM THE STATE TREASURER’S CANNABIS WORKING GROUP 2–4 (2017), <https://www.treasurer.ca.gov/comm-external-urls/banking-access-strategies.pdf> [<https://perma.cc/ARW8-RRDQ>] (“The cannabis industry’s inability to get basic banking services is an urgent public policy issue requiring concerted action by state and local governments, the cannabis industry, and financial institutions.”).

44. *The Controlled Substances Act*, *supra* note 39.

45. *Id.*

46. Second Cole Memorandum, *supra* note 38.

47. *Id.*

Specifically, the Second Cole Memorandum stated that “[f]inancial transactions involving proceeds generated by [cannabis]-related conduct can form the basis for prosecution under . . . money laundering statutes (18 U.S.C. §§ 1956 and 1957), the unlicensed money transmitter statute (18 U.S.C. § 1960), and the [Bank Secrecy Act].”<sup>48</sup> It is an open question of what would give rise to such a prosecution.<sup>49</sup> One possibility is when such a transaction is intended to violate federal law.

The Second Cole Memorandum also did several other things that its predecessor guidance did not. For example, this administrative pronouncement warned federally regulated financial institutions<sup>50</sup> against working with participants in the legal cannabis industry.<sup>51</sup> It also highlighted the potential federal sanctions that these financial institutions could be confronted with, like fines.<sup>52</sup>

Finally, the Second Cole Memorandum noted that it was meant to complement the Treasury Department’s Financial Crimes Enforcement Network’s (FinCEN) work.<sup>53</sup> As such, it opened the door for additional and different sanctions to be imposed on financial institutions by other federal agencies.<sup>54</sup> In other words, the first and second Cole Memorandums further

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48. *Id.*

49. *Id.* Unfortunately, this guidance provides few useful examples of what actions, or inactions, may violate the law.

50. As of the writing of this essay, which is fall of 2022, all financial institutions and specifically state-chartered banks are at least subject to two federal banking regulators. *See, e.g.*, LISSA L. BROOME, JERRY W. MARKHAM & JOSE M. GABILONDO, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES: CASES AND MATERIALS 127–30 (6th ed. 2022) (noting that banks are subject to a number of different regulators and that there are generally two different primary regulators for banks). Depending on the status of the financial institutions as a state-member or non-member bank either the FDIC or the Federal Reserve is the primary federal regulator of these institutions. *Id.*

51. Second Cole Memorandum, *supra* note 38.

52. *Id.* The memorandum further notes that “[t]ransactions by or through a money transmitting business involving funds ‘derived from’ [cannabis]-related conduct can also serve as a predicate for prosecution . . . . Additionally, financial institutions that conduct transactions with money generated by [cannabis]-related conduct could face criminal liability under the [Bank Secrecy Act] for, among other things, failing to identify or report financial transactions that involve[] the proceeds of [cannabis]-related violations of the [Controlled Substances Act].” *Id.*

53. *Id.*; *see also* DEP’T OF THE TREASURY FIN. CRIMES ENF’T NETWORK, GUIDANCE FIN-2014-G001, BSA EXPECTATIONS REGARDING MARIJUANA-RELATED BUSINESSES (Feb. 14, 2014), <https://www.fincen.gov/sites/default/files/guidance/FIN-2014-G001.pdf> [<https://perma.cc/VNJ3-NEX4>]. The guidance does not provide any advice on how financial institutions may comply or avoid sanctions.

54. For example, in footnote 1 of the Second Cole memorandum, DOJ underscores this point by noting:

FinCEN[’s] guidance addresses the filing of Suspicious Activity Reports (SAR) with respect to [cannabis]-related businesses, and in particular the importance of considering the eight federal enforcement priorities mentioned [in this memorandum], as well as state law. As discussed in FinCEN’s guidance, a financial institution providing financial services to a [cannabis]-related business that it reasonably believes, based on its customer due diligence, does not implicate one of the federal enforcement priorities or violate state law, would file a

increased the uncertainty that was faced by many participants in the ostensibly legal cannabis industry.<sup>55</sup>

## 2. *Financial Crimes Enforcement Network Guidance*

FinCEN is a bureau of the U.S. Department of the Treasury, which was created to combat money laundering, terrorism financing, and other financial crimes.<sup>56</sup> The Secretary of the Treasury is authorized to issue, administer, and enforce federal regulations under the Currency and Financial Transactions Reporting Act of 1970.<sup>57</sup> The Currency and Financial Transactions Reporting Act of 1970, which is commonly referred to as the Bank Secrecy Act, requires every financial institution operating in the United States to assist the federal government in detecting and deterring a range of crimes.<sup>58</sup>

FinCEN carries out its administrative mandate, primarily, through comprehensive analyses of data that it receives, maintains, and shares with other federal agencies.<sup>59</sup> Under the Bank Secrecy Act, regulated parties are required to monitor their clients' transactions, compile data, and file certain reports with FinCEN.<sup>60</sup> Regulated parties may be required to file four different types of reports: Suspicious Activity Reports (SARs), Currency Transaction Reports (CTRs), Designation of Exempt Person Reports (DOEPs), and Registered Money Service Business Reports (RMSBs).<sup>61</sup>

The filing of FinCEN reports is a federal legal requirement, due to the fact that this requirement is a “clear and manifest purpose of Congress,” and

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“[Cannabis] Limited” SAR, which would include streamlined information. Conversely, a financial institution filing a SAR on a [cannabis]-related business it reasonably believes, based on its customer due diligence, implicates one of the federal priorities or violates state law, would be label the SAR “[Cannabis] Priority,” and the content of the SAR would include comprehensive details in accordance with existing regulations and guidance.

Second Cole Memorandum, *supra* note 38, at 2 n.1.

55. See, e.g., Shariq Khan, *U.S. Pot Sellers Stash Cash as Banks Leave Them High and Dry*, REUTERS (May 24, 2021, 1:17 AM), <https://www.reuters.com/world/us/us-pot-sellers-stash-cash-banks-leave-them-high-dry-2021-05-24/> [<https://perma.cc/8JKV-B6CN>] (noting that some cannabis farmers hide cash in trees or lose count of the dollar bills they store in lockers).

56. Treasury Order 180-01, U.S. DEP'T TREAS. (July 1, 2014), <https://home.treasury.gov/about/general-information/orders-and-directives/treasury-order-180-01> [<https://perma.cc/FK62-778R>]; Financial Crimes Enforcement Network, 67 Fed. Reg. 64697 (Sept. 26, 2002); USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272, Title III, Subtitle B, § 361(a)(2) (Title III is entitled “International Money Laundering Abatement and Antiterrorist Financing Act of 2001”) (describing FinCEN's authority).

57. See The Bank Secrecy Act (BSA), 31 U.S.C. 5311–5336.

58. *Id.*

59. *Id.*

60. *Id.*

61. See, e.g., 31 C.F.R. Chapter X (2022); 12 C.F.R. §§ 21.11, 163.180, 208.62, 353.3, 748.1 (2022) (describing cannabis industry specific SARs). It should be noted that the cannabis industry has additional reporting requirements including the filing of Marijuana Suspicious Activity Reports (MSARs). See *supra* note 54.

thus unaffected by state law.<sup>62</sup> Compared to national banks, which are usually larger financial institutions and chartered at the federal level, exclusively state-authorized and smaller financial institutions often find it more costly to file FinCEN reports due to their much smaller size.<sup>63</sup> These higher compliance costs arise, mostly, from the latter's modest economies of scale and weak bargaining power.<sup>64</sup> It is for this reason that the FinCEN reports, indirectly, limit infant industries' access to financial services.<sup>65</sup>

### *B. Invalid State Solutions*

State governments also have sought to increase the cannabis industry's access to financial services through their creation of new, or special purpose, state banking charters. For example, Colorado introduced the "Cannabis Financial Services Cooperatives Act" in 2014.<sup>66</sup> This bill created state-authorized "cannabis credit co-op[s],"<sup>67</sup> which are "a type of financial services entity . . . restricted to . . . [working with legal persons] . . . licensed to . . . operate a [cannabis] business."<sup>68</sup>

Upon enactment, every cannabis credit co-op would have been subject to regulatory supervision by the Colorado State Commissioner of Financial Services.<sup>69</sup> To avoid any confusion, these limited subject matter entities were expressly prohibited from calling themselves "credit unions" or "banks."<sup>70</sup> This prohibition was important, at least from the perspective of certain legislators, since cannabis credit co-ops were relieved of the obligation to obtain any federal deposit insurance.<sup>71</sup>

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62. *Constitution Annotated*, *supra* note 32. Congress expressly imposed this requirement under the Patriot Act. See USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272, Title III, Subtitle B, § 361(a)(2) (Title III is entitled "International Money Laundering Abatement and Antiterrorist Financing Act of 2001.").

63. Cf. Jennifer Surane & Francine Lacqua, *Jamie Dimon Says US Needs to 'Finish' the Bank Crisis*, BLOOMBERG L. (May 11, 2023, 9:34 AM), <https://www.bloomberg.com/news/articles/2023-05-11/jamie-dimon-warns-regulators-to-not-overreact-to-bank-crisis#xj4y7vzkg> [<https://perma.cc/UW7Y-8VS9>] (quoting JPMorgan's Jamie Dimon as noting that "[i]f you overdo certain rules, requirements, regulations – there are some of these community banks that tell me they have more compliance people than loan officers").

64. See, e.g., Ernest L. Simons IV, *Anti-Money Laundering Compliance: Only Mega Banks Need Apply*, 17 N.C. BANKING INST. 249, 251–53 (2013).

65. *Id.*

66. H.B. 14-1398, 2014 Reg. Sess. (Colo. 2014), *codified at* COLO. REV. STAT. § 11-33-101 (repealed 2020).

67. COLO. REV. STAT. § 11-33-103(1) (repealed 2020).

68. H.B. 14-1398, 2014 Reg. Sess., § 1 (Colo. 2014).

69. COLO. REV. STAT. §§ 11-33-103(2), 11-33-104 (repealed 2020).

70. COLO. REV. STAT. § 11-33-108(1)(a) (repealed 2020).

71. COLO. REV. STAT. § 11-33-104(3)(a) (repealed 2020) (explaining that "[i]f federal deposit insurance provided by the federal deposit insurance corporation or national credit union administration becomes available for banks, savings and loan associations, and credit unions organized to provide financial services to the licensed [cannabis] industry, the commissioner may determine that the continued issuance of charters under this article is no longer necessary or desirable.").

In order to receive a state banking charter, cannabis credit co-ops were not only required to submit evidence that they were accepted into the federal reserve system,<sup>72</sup> but also needed to use best practices for handling cannabis industry proceeds.<sup>73</sup> In addition to any FinCEN Suspicious Activity Reports, co-ops also were obligated to file similar reports with state-level regulators.<sup>74</sup> Unfortunately, cannabis credit co-ops quickly fell out of favor and were abolished. The reason for this abolition was the requirement that each co-op had to secure a Federal Reserve master account.<sup>75</sup>

### C. Potentially Valid Federal Solutions

As of this writing, at least four bills, which seek to increase the cannabis industry's access to financial services, have been introduced in the U.S. Congress.<sup>76</sup> The first of these potentially valid federal solutions is the Secure and Fair Enforcement Banking Act (SAFE Act).<sup>77</sup> Although this bill does not seek to harmonize the treatment of cannabis under federal and state laws, it does try to protect U.S. banking, payment, and insurance service providers from federal sanctions.<sup>78</sup> It does so by creating a safe harbor for financial institutions.<sup>79</sup> This bill was voted on, but never enacted.<sup>80</sup>

The second bill that sought to increase the cannabis industry's access to low-cost financial services is the Strengthening the Tenth Amendment

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72. COLO. REV. STAT. § 11-33-104(4)(a) (repealed 2020) (“Before the commencement of operations or the conduct of business by the co-op, the incorporators of the co-op must provide to the commissioner written evidence of approval by the federal reserve system board of governors for access by the co-op to the federal reserve system.”).

73. COLO. REV. STAT. § 11-33-126(1) (repealed 2020).

74. COLO. REV. STAT. § 11-33-127 (repealed 2020). The state reports are called suspicious transaction reports or STRs rather than FinCEN's suspicious activities reports or SARs. The Act also directly refers to the Bank Secrecy Act or BSA. *See, e.g.*, COLO. REV. STAT. § 11-33-127(1)(b)(II) (repealed 2020).

75. Colorado ultimately repealed the Act establishing Cannabis Co-ops after zero co-ops were chartered. *See* H.B. 20-1217, §§ 2-5; 24-34-104 (IX); 13-4-102(II); 39-28.8-501 (J); 44-10-401(5) (Colo. 2020).

76. *Cf.* SCOTT, *supra* note 15, at 19. In the 117th Congress, alone, thirty-six different marijuana related bills were introduced in the House and twelve in the Senate. For a complete overview of the different proposals and their specific focus, see Kristine Blackwood et al., *Cannabis State-of-Play*, ARNOLD & PORTER ADVISORY (Dec. 8, 2022), <https://www.arnoldporter.com/en/perspectives/advisories/2022/12/cannabis-state-of-play> [<https://perma.cc/5KC4-LGPU>] (noting that the United States saw “increasingly liberalized laws at the state level during the early 21st century”).

77. H.R. 1595, 116th Cong. (2019).

78. *Id.*

79. *See* H.R.1595 - SAFE Banking Act of 2019, CONGRESS.GOV, <https://www.congress.gov/bill/116th-congress/house-bill/1595> [<https://perma.cc/PHP5-8Z5K>].

80. *Id.* Also note that while the SAFE Act itself remains widely supported among legislators, the Act does not include any social justice and economic development incentives. The Cannabis Administration and Opportunity Act (CAOA) discussed below was meant to join the SAFE Act with provisions, such as social and economic incentives, expungement, and firearm licensing restrictions. *Infra* note 90.

Through Entrusting States Act (STATES Act).<sup>81</sup> Although the STATES Act would also amend the Controlled Substances Act, mostly by limiting its ability to punish cannabis related activities that are legal under state law, its focus is on sub-national rights.<sup>82</sup> Among the possible effects of the STATES Act is the removal of barriers to thrifts, banks, and credit unions providing financial services to the cannabis industry.<sup>83</sup> As of this writing, it is unclear if this proposed legislation will ever be scheduled for a vote.<sup>84</sup>

The third proposal is the Marijuana Opportunity Reinvestment and Expungement Act (MORE Act).<sup>85</sup> The MORE Act would legalize cannabis across the United States, de-schedule it as an illegal substance, and remove it from the Controlled Substances Act list.<sup>86</sup> In addition, certain convictions of non-violent possession crimes would be expunged.<sup>87</sup> Lastly, the Act calls for the creation of a social equity tax and a trust fund for the benefit of communities that were hardest hit by the War on Drugs.<sup>88</sup> It is an open question if this bill will ever come up for a full vote.<sup>89</sup>

The fourth, and most recent, bill is the Cannabis Administration and Opportunity Act (CAOA).<sup>90</sup> CAO A was put before Congress as part of an omnibus bill,<sup>91</sup> which focused on legalizing cannabis<sup>92</sup> and expunging certain federal convictions.<sup>93</sup> A number of new tax reform options, which would provide additional funding for community reinvestment and drug abuse treatment, also were included.<sup>94</sup> The relevant provisions of this legislation were referred to the Senate's Committee on Finance, but no further action has been taken during the current session.<sup>95</sup>

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81. H.R. 2093, 116th Cong. (2019).

82. *Id.*

83. *Id.*

84. *Id.*

85. H.R. 3617, 117th Cong. (2021).

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. S. 4591, 117th Cong. (2022).

91. *Id.*; see also Natalie Fertig, *Schumer's Legal Weed Bill Is Finally Here*, POLITICO (July 21, 2022, 2:58 PM), <https://www.politico.com/news/2022/07/21/schumer-legal-weed-bill-00047058> [<https://perma.cc/MBX7-UTKD>] (noting that Senate leaders introduced sweeping cannabis reform legislation, which seeks to remove federal prohibitions on marijuana trades).

92. S. 4591, 117th Cong. § 101 (2022). Other legislative proposals in the 117th Congress also focused on removing marijuana from the CSA, such as the Homegrown Act of 2021, H.R. 2649, 117th Cong. (2021); Common Sense Cannabis Reform for Veterans, Small Businesses, and Medical Professionals Act, H.R. 3105, 117th Cong. (2021). See also Marijuana Justice Act of 2019, H.R. 1456, 116th Cong. (2019); S. 597, 116th Cong. (2019).

93. S. 4591, 117th Cong. § 311 (2022).

94. *Id.* §§ 301–303.

95. See, e.g., *S.4591 – Cannabis Administration and Opportunities Act, All Actions*, CONGRESS.GOV, <https://www.congress.gov/bill/117th-congress/senate-bill/4591/all-actions?overview>

#### D. Potentially Valid State Solutions

In light of the fact that there has been little action at the federal level, several potentially valid state solutions have been proposed. One option, which has yet to be fully explored in the United States, is to create limited subject matter institutions that focus upon infant industries.<sup>96</sup> Such banks draw, only, upon sub-national legal authority to avoid conflicts between federal and state laws.<sup>97</sup>

### III. ILLUSTRATIVE EXAMPLE OF A LIMITED SUBJECT MATTER BANK

#### A. The Bank of North Dakota

Sub-national financial institutions, owned and operated by states, are not new concepts. In fact, several state-owned and operated banks were

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=closed#tabs [https://perma.cc/74RV-KKE7]. As with some of the other legislative proposals that are mentioned above, the outcome of CAO remains uncertain. *See, e.g.,* Kyle Jaeger, *McConnell Brags About Marijuana Banking Defeat in Defense Bill, Signaling He'll Fight to Stop It in Omnibus Spending Too*, MARIJUANA MOMENT (Dec. 7, 2022), <https://www.marijuanamoment.net/mcconnell-brags-about-marijuana-banking-defeat-in-defense-bill-signaling-hell-fight-to-stop-it-in-omnibus-spending-too/> [https://perma.cc/4L7Y-YZ64]; Karl Evers-Hillstrom, *Marijuana Advocates Stunned After McConnell Opposition Doooms Banking Bill*, HILL (Dec. 21, 2022, 6:00 AM), <https://thehill.com/policy/finance/3782514-marijuana-advocates-stunned-after-mcconnell-opposition-doooms-banking-bill/> [https://perma.cc/MT5U-BW9R] (noting that some pro-cannabis advocates are upset about Senate GOP Leader Mitch McConnell's inaction on the pending bill).

96. *See* YOLANDA K. KODRZYCKI & TAL ELMATAD, NEW ENG. PUB. POL'Y CTR., *THE BANK OF NORTH DAKOTA: A MODEL FOR MASSACHUSETTS AND OTHER STATES?*, RSCH. REP. 11-2 (2011), <https://www.bostonfed.org/publications/new-england-public-policy-center-research-report/2011/the-bank-of-north-dakota-a-model-for-massachusetts-and-other-states.aspx> [https://perma.cc/7SXX-VDDD]. It should be noted that the Territorial Bank of American Samoa, i.e., American Samoa Bank, is another financial institution that may be considered state-owned. It is different from the other banks that are discussed in this essay, however, as it was established by and in an unincorporated U.S. territory. And as a Bank Holding Company, the American Samoa Bank also is subject to regulatory oversight by the Federal Reserve. *See, e.g.,* *Territorial Bank of American Samoa*, <https://www.mytbas.com/> [https://perma.cc/4NTS-UGNH]. American Samoa Bank is a traditional full-service commercial bank, accepts deposits, makes loans, sells insurance, and provides other services to the public; it provides services only locally in American Samoa. *See also* Rob Blackwell, *American Samoa Finally Gets a Public Bank. And U.S. States Are Watching*, AM. BANKER (Apr. 30, 2018, 9:45 PM), <https://www.americanbanker.com/news/american-samoa-finally-gets-a-public-bank-and-us-states-are-watching> [https://perma.cc/DV5G-JWPB] (“The Federal Reserve is allowing the Territorial Bank of American Samoa access to the U.S. payment system nearly two years after the bank first applied.”); Rob Blackwell, *How Far Does American Samoa Have to Go to Get a Bank?*, AM. BANKER (July 31, 2017, 5:11 PM), <https://www.americanbanker.com/news/how-far-does-american-samoa-have-to-go-to-get-a-bank> [https://perma.cc/9E6B-UNQC] (“Though the Territorial Bank of American Samoa has received no attention stateside, it is at the nexus of several policy debates, including the high requirements demanded of new entrants to the banking system and how best to bring underbanked consumers into the financial system.”).

97. *Cf.* SCOTT, *supra* note 15, at 19.



chartered in the past century alone.<sup>98</sup> As of this writing, only one remains in operation.<sup>99</sup> This institution is called the Bank of North Dakota.<sup>100</sup>

The Bank of North Dakota, which is commonly referred to as the “Bank of the People,” was created to address the agricultural industry’s lack of access to capital.<sup>101</sup> Opening with an initial capitalization of \$2 million in 1918,<sup>102</sup> the Bank of North Dakota is a limited subject matter bank that provides a range of financial services.<sup>103</sup> This institution later received additional deposits of \$16 million that year, which helped to finance in-state agricultural projects.<sup>104</sup>

This limited subject matter bank has gone beyond its initial agricultural focus and now funds infrastructure, natural disaster recovery, home lending, and student loan projects.<sup>105</sup> As of 2021, the Bank of North Dakota reported a profit of about \$144.2 million with a 15 percent rate of return.<sup>106</sup> Such high returns are typical for this state-owned institution, whereas similarly situated private banks typically yield fewer annual profits and only a 14 percent average return on equity.<sup>107</sup>

Today, this limited subject matter institution operates as a correspondence or central bank.<sup>108</sup> In order to do this work, the Bank of

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98. See Kodrzycki & Elmatad, *supra* note 96, at 6.

99. N.D. CENT. CODE, § 6-09-01 (1943).

100. See Kodrzycki & Elmatad, *supra* note 96.

101. Interestingly the establishment of the Bank of North Dakota was also the result of a socialist political party movement called the Nonpartisan League that won the governorship and the majority in the house and senate of North Dakota in 1918. The creation of “rural credit banks operated at cost” was one of the main political goals of the Nonpartisan League and directly contributed to their political win in 1918. See, e.g., Bank of N.D., *The Early Years*, YOUTUBE (June 12, 2019), <https://www.youtube.com/watch?v=m8l4q7yza9U&t=30s> [<https://perma.cc/3QPJ-GQST>].

102. See, e.g., Letter from F.W. Cathro, Director General, The Bank of North Dakota 77-28 (Feb. 2, 1920), <http://thebndstory.nd.gov/wp-content/uploads/2019/08/BND-Charter-1920.pdf> [<https://perma.cc/9GYT-EUCT>]. According to various sources, \$2,000,000 in 1918 is the equivalent to about \$41,000,000 in 2023. See, e.g., Fed. Rsrv. Bank of Minneapolis, *Inflation Calculator*, <https://www.minneapolisfed.org/about-us/monetary-policy/inflation-calculator> [<https://perma.cc/LFB6-VA7D>].

103. See N.D. CENT. CODE § 6-09-01 (1943)

104. See F.W. Cathro, *supra* note 102. According to various sources, \$16,000,000 in 1918 is the equivalent to about \$330,000,000 in 2023. See, e.g., Fed. Rsrv. Bank, *supra* note 102.

105. See F.W. Cathro, *supra* note 102.

106. Bank of N.D., *Bank of North Dakota Releases 2021 Annual Report and S&P Rating* (May 24, 2022), <https://bnd.nd.gov/bank-of-north-dakota-releases-2021-annual-report-sp/> [<https://perma.cc/65PJ-7QZA>].

107. J.B. Maverick, *What Is the Average Return on Equity (ROE) of Banks?*, INVESTOPEDIA (July 20, 2022), <https://www.investopedia.com/ask/answers/040815/what-level-return-equity-common-company-banking-sector.asp> [<https://perma.cc/U8F6-XAGF>]; cf. BD. OF GOVERNORS, FED. RSRV. SYS., SUPERVISION AND REGULATION REPORT (2021), <https://www.federalreserve.gov/publications/files/202111-supervision-and-regulation-report.pdf> [<https://perma.cc/X56V-KB5K>].

108. See, e.g., N.D. CENT. CODE, § 6-09-11 (1943) (“For banks that make the Bank of North Dakota a reserve depository, it may perform the functions and render the services of a clearinghouse, including all facilities for providing domestic and foreign exchange, and may rediscount paper, on such

North Dakota Act created the related State Industrial Commission.<sup>109</sup> The Commission is charged with overseeing the Bank.<sup>110</sup> Its membership is made up of constitutional officers, i.e., Governor, Attorney General, and Agricultural Commissioner.<sup>111</sup>

The Bank of North Dakota, currently, is not a member of the Federal Deposit Insurance Corporation (FDIC).<sup>112</sup> Instead, the bank's deposits are guaranteed by the full faith and credit of its home state.<sup>113</sup> In addition, in recent years, the Bank of North Dakota had a reported Tier One

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terms as the industrial commission shall provide.”). Correspondent banking is defined as “an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks.” Committee on Payments and Market Infrastructures, *A Glossary of Terms Used in Payments and Settlement Systems*, BANK INT’L SETTLEMENTS (Oct. 17, 2016), [www.bis.org/cpmi/publ/d00b.htm?m=3%7C16%7C266](http://www.bis.org/cpmi/publ/d00b.htm?m=3%7C16%7C266) [https://perma.cc/Z54A-3FCB]. Whereas central banking may do many of the same things, while also providing additional and different services to state, national, or other financial institutions. *See, e.g.*, FED. RSRV. PUBL’NS, U.S. FED. RSRV. SYS., *THE FED EXPLAINED: WHAT THE CENTRAL BANK DOES* 104 (11th ed. 2021), <https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf> [https://perma.cc/556U-FBSD] (noting that the Federal Reserve provides several types of correspondent banking, which include non-interest-bearing deposits accounts, securities safekeeping accounts, and gold safekeeping). It also may provide cash, which is not provided by most central banks. *Id.* at 98.

109. *See* N.D. CENT. CODE. § 6-09-02 (1989).

110. N.D. CENT. CODE. §§ 6-09-02 (1989); 54-17-01 (1981).

111. N.D. CENT. CODE. § 54-17-02 (1981).

112. *Id.* FDIC officials are considering changes to the traditional way that banks pay for federal deposit insurance, in anticipation of future economic downturns. SVB’s failure to purchase adequate amounts of this insurance cost the federal government approximately \$22.5 billion. Of this total, about \$19.2 billion was covered through a special assessment. It is unclear how this loss will be allocated, but the very largest banks are likely paying the lion share. *See, e.g.*, Evan Weinberger, *Bank Insurance Fee Talks Pose Complicated Challenges for FDIC*, BLOOMBERG L. (Apr. 24, 2023, 4:00 AM), <https://news.bloomberglaw.com/banking-law/bank-insurance-fee-talks-pose-complicated-challenges-for-fdic> [https://perma.cc/JSP5-F8HG] (noting that negotiations have “picked up pace following the collapse of Silicon Valley Bank and Signature Bank, but putting those ideas into practice will be an uphill climb”).

113. N.D. CENT. CODE. § 6-09-10 (1943) (“All deposits in the Bank of North Dakota are guaranteed by the state. Such deposits are exempt from state, county, and municipal taxes of any and all kinds.”). One important benefit of such an arrangement is the fact that the Bank of North Dakota is unlikely to ever be bailed out by the U.S. federal government. *See, e.g.*, Colby Smith, James Politi, James Fontanella-Khan & Brooke Masters, *US Regulators Protect Silicon Valley Bank Depositors and Shore Up Financial System*, FIN. TIMES (Mar. 12, 2023), <https://www.ft.com/content/8e0be2f4-0b41-4768-b586-49180980ba90> [https://perma.cc/ZRY4-QF4H] (noting that “[t]he Federal Reserve announced a new lending facility . . . aimed at providing extra funding to eligible institutions to ensure that ‘banks . . . meet the needs of all their depositors’” after SVB’s implosion. By doing so, it may limit cascade effects); *see also* Jeanna Smialek & Alan Rappoport, *Was This a Bailout? Skeptics Descend on Silicon Valley Bank Response.*, N.Y. TIMES (Mar. 13, 2023), <https://www.nytimes.com/2023/03/13/business/economy/svb-bailout-questions.html> [https://perma.cc/5MVK-VKU6] (citing “Steven Kelly, [a] senior research associate at Yale’s program on financial stability,” as saying that “[t]he Fed has basically just written insurance on interest-rate risk for the whole banking system”). Maybe even more importantly, U.S. states cannot make use of bankruptcy law in dealing with their financial issues. *See, e.g.*, David Skeel, *A Bankruptcy Law—Not Bailouts—for the States*, WALL ST. J. (Jan. 18, 2011, 12:01 AM), <https://www.wsj.com/articles/SB10001424052748703779704576073522930513118> [https://perma.cc/A5WD-UHH4] (arguing in favor of implementing a new bankruptcy law for states).

capitalization level in excess of 20 percent.<sup>114</sup> This mandatory capitalization is significantly higher than what is called for by otherwise similarly situated national banks over the same time period.<sup>115</sup>

The Bank of North Dakota also is not a member of the Federal Reserve System.<sup>116</sup> But it does maintain a relationship with the Federal Reserve Bank in Minneapolis, Minnesota.<sup>117</sup> This relationship allows for processing of interstate checks, depositing of excess cash, meeting reserve requirements, and a right to access the Fed's book-entry system and discount window borrowing.<sup>118</sup>

None of the above protections are required under the Bank of North Dakota Act.<sup>119</sup> Nor are any of these indirect forms of depository insurance necessary for the Bank to operate.<sup>120</sup> Instead, each protection is meant to lower transaction costs and reduce the risk of potential financial losses.<sup>121</sup>

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114. See, e.g., S&P GLOBAL RATINGS, RATINGSDIRECT: BANK OF NORTH DAKOTA 10 (2021), [https://bnd.nd.gov/pdf/sp\\_report\\_2021.pdf](https://bnd.nd.gov/pdf/sp_report_2021.pdf) [<https://perma.cc/Z838-BPQE>] (reporting a Tier 1 capital ratio of 20.12%). Equally impressive are the reported loan loss reserves of 67.65%. *Id.*; see also, BANK OF N.D., BANK OF NORTH DAKOTA BALANCE SHEETS DECEMBER 31, 2022 AND 2021 UNAUDITED, CALL REPORT (Feb. 3, 2023), <https://bnd.nd.gov/pdf/12-22callreport.pdf> [<https://perma.cc/22EJ-MNP9>] (reporting that the “Bank of North Dakota is committed to exceeding the ratios for a ‘well-capitalized’ correspondent . . . [reporting] capital and leverage ratios on a quarterly basis”). The Tier 1 capital ratio, in 2022, remained high. And, as of this writing, it remains close to 19%. *Id.*

115. See 12 C.F.R. § 324.10(a)(1)(i)–(ii) (2022). In the United States, all banks are currently required to at least maintain a capital level consisting of 4.5 percent common equity tier one capital and 6 percent tier one capital. *Id.* Tier one capital is the most important and most loss-absorbing form of capital and refers to the sum of common equity tier one capital and additional tier one capital. See Tier 1 capital, 12 C.F.R. § 324.2 (2022). “Additional tier 1 capital is the sum of additional tier 1 capital elements and any related surplus, minus the regulatory adjustments and deductions in § 324.22.” 12 C.F.R. § 324.20(c) (2022).

116. See *History of BND*, BANK OF N.D., <https://bnd.nd.gov/history-of-bnd/> [<https://perma.cc/9UWA-SYTR>].

117. *Id.*

118. See, e.g., *id.* (“BND has a business relationship with the Minneapolis Federal Reserve Bank. The Bank does check processing, deposits excess cash balances, maintains a reserve requirement, safe keeps all its Fed book entry securities and has discount window borrowing authority.”).

119. See N.D. CENT. CODE §§ 6-09-01 to -51 (1943) (describing the minimum requirements).

120. See 12 C.F.R. § 324.10(a)(1)(i)–(ii) (2022) (defining minimum capital requirements for insurance eligibility).

121. See, e.g., MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 1018 (3d ed. 2021) (noting that the discount window of the Federal Reserve after reforms in 2003 allowed “[h]ealthy banks . . . to take out primary credit loans with no questions asked . . .” thereby, limiting transaction costs and lowering the risk of paying significantly higher interest on private loans during times of financial distress); see also FED. DEPOSIT INS. CORP. BOARD OF DIRECTORS, FDIC’S SUPERVISION OF SIGNATURE BANK 12 (2023), <https://www.fdic.gov/news/press-releases/2023/pr23033a.pdf> [<https://perma.cc/R74W-YPPU>] (noting that the failure of Signature Bank was, in part, due to its ineligibility to access the Federal Reserve Bank of New York’s Discount Window lending, which may have limited the harm caused by bank runs); Hannah Miao, Gregory Zuckerman & Ben Eisen, *How the Last-Ditch Effort to Save Silicon Valley Bank Failed*, WALL ST. J. (Mar. 22, 2023), <https://www.wsj.com/articles/how-the-last-ditch-effort-to-save-silicon-valley-bank-failed-89619cb2?mod=djemalertNEWS> [<https://perma.cc/U7TE-RCLF>] (describing how SVB may have been saved through accessing the Federal Reserve’s Discount Window,

But, even without any of these additional types of insurance, the Bank of North Dakota could be considered a highly profitable, capitalized, accountable, and safe financial institution.<sup>122</sup> As such, it is a good example of how states may provide financial services to their infant industries.

### *B. One Viable Option for Creating a State-Owned Cannabis Industry Bank*

One viable way to create a state-owned cannabis bank is to follow the model of the Bank of North Dakota. As such, it may encourage states to make better use of their scarce public resources while also limiting conflicts between state and federal cannabis laws. Both goals may be achieved through passage of new state-level authorizing legislation or even under existing laws.

The proposed bank's initial seed money could be drawn from cannabis-related revenues such as licensing fees or excise taxes.<sup>123</sup> Such revenues are quite significant.<sup>124</sup> For example, recent projections indicated that Illinois may generate about \$600 million annually in such revenues.<sup>125</sup>

Longer-term solvency concerns could be addressed by requiring the bank to keep a certain amount of money on-hand, i.e., a minimum level of capitalization.<sup>126</sup> The required amount may be adjusted, on a periodic basis,

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but "SVB was too late . . . and the Fed didn't extend its own daily deadline of 4 p.m. PT for collateral transfers to help SVB. Time ran out on the bankers and SVB couldn't get the money that day"); Nicholas Reimann, *Banks Rush to Borrow Record-Breaking \$165 Billion from Fed After SVB Failure*, FORBES (Mar. 16, 2023, 7:39 PM), <https://www.forbes.com/sites/nicholasreimann/2023/03/16/banks-rush-to-borrow-record-breaking-165-billion-from-fed-after-svb-failure/?sh=48a00ee245bc> [<https://perma.cc/3DPE-AKDY>] ("Banks worried about liquidity in the wake of Silicon Valley Bank's collapse took out a combined \$164.8 billion in loans from the Federal Reserve," which allowed these financial institutions to limit their risk of loss while avoiding certain transaction costs in the short-term (like higher interest rates)).

122. Cf. SCOTT, *supra* note 15, at 19; see also *supra* notes 114–15 and accompany text.

123. If necessary, additional budgetary funds could be provided through the issuance of a general state obligation bond approved by the legislature. A general obligation bond is a municipal bond backed by the credit and taxing power of the issuing state rather than the revenue from the bank. Cf. James Chen, *General Obligation (GO) Bond: Definition, Types, Vs. Revenue Bond*, INVESTOPEDIA (Aug. 17, 2020), <https://www.investopedia.com/terms/g/generalobligationbond.asp> [<https://perma.cc/29T5-5JPA>] ("General obligation bonds are issued with the belief that a municipality will be able to repay its debt obligation through taxation or revenue from projects. No assets are used as collateral.").

124. See Press Release, Ill. Pol'y Inst., 'Half-Baked' Illinois Marijuana Roll-Out Costs State \$600M (Apr. 20, 2022), <https://www.illinoispolicy.org/press-releases/half-baked-illinois-marijuana-roll-out-costs-state-600m/> [<https://perma.cc/3VT3-ZFS6>] (referencing a study commissioned by Illinois law makers in 2019, "which estimated Illinois could produce \$440 million to \$676 million in annual tax revenue").

125. *Id.*

126. Cf. SCOTT, *supra* note 15, at 19.

depending on the characteristics of the cannabis industry in a given state.<sup>127</sup> Such flexibility may be needed because having a limited subject matter, regardless of what it is, may increase the bank's risk profile.<sup>128</sup> As such, the proposed bank should maintain high capital levels and adopt any other relevant best practices that limit its risk of loss.<sup>129</sup>

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127. See, e.g., OFF. OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK – CONCENTRATIONS OF CREDIT: VERSION 2.0, at 2 (2020), <https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/concentrations-of-credit/pub-ch-concentrations.pdf> [<https://perma.cc/8RZ9-ZRRD>] (“Concentrations can accumulate within and across products, business lines, geographic areas, countries, and legal entities.”). One approach taken by banks to identify and monitor concentration risk is combining a size limit of less than 25 percent of capital with a particular risk benchmark, such as loans. As such, a state cannabis industry bank may choose to define a concentration as any pool with an exposure greater than 20 percent of its capital exhibiting a level of special mention or inventory financing loans of a specific type of cannabis-related business, i.e., dispensaries, cultivators, or transporters. On the other hand, the bank may also choose to monitor risk levels based on dynamic changes in its portfolio that may provide early indications of increasing risk. Part of any approach should be stress testing and mitigations strategies. To stress test, the state bank may alter its assumptions about one or more of its financial or economic variables to determine its potential impact on portfolio performance. Of course, there are many different methodologies to calculate concentration risk, such as the Herfindahl-Hirschman index (HHI), Simpson's equitability index, Shannon-Wiener index, Pielou's evenness index, or Moody's Diversity Score, to just name a few. However, all of these methodologies have some shortcomings and may only be able to provide insight into particular markets. For example, the HHI index, which is often used in the antitrust and banking context, is not particularly useful, or even dependable, if markets are complex or lack historical comparisons. As a result, these indexes may only be useful as screening tools. See, e.g., U.S. Dep't of Just., *Herfindahl-Hirschman Index*, <https://www.justice.gov/atr/herfindahl-hirschman-index> [<https://perma.cc/D52F-YDMC>] (“Transactions that increase the HHI . . . are presumed likely to enhance market power . . .” (emphasis added)).

128. Cf. SCOTT, *supra* note 15, at 19.

129. There are many examples of potential best practices. See, e.g., FSI CONNECT, BANK FOR INT'L SETTLEMENTS, THE CAPITAL BUFFERS IN BASEL III – EXECUTIVE SUMMARY (2019), [https://www.bis.org/fsi/fsisummaries/b3\\_capital.pdf](https://www.bis.org/fsi/fsisummaries/b3_capital.pdf) [<https://perma.cc/57PG-TJPZ>] (Capital buffers are part of what is generally known as Basel III, which “is a comprehensive set of measures developed by the Basel Committee on Banking Supervision (BCBS) to address the fault lines in the financial system exposed by the” Great Recession in 2007–08.). Other relevant examples of best practices may be periodic review of HTM (“held-to-maturity”) and interest expense levels, as well as updating IRRBB deposit models (“Interest rate risk in the banking book”), avoiding growth of negative NII (“Net Interest Income”), and maintaining appropriate NIM (“Net Interest Margin”) levels at the same time. It is well-established that the reasons for the string of recent bank failures included the refusal to collect, analyze, and report key information, like net stable funding ratios, despite financial institutions being legally required to do this work. See, e.g., Lorenzo Migliorato, *Like SVB, Five Other US Lenders Reported Negative NII Growth in 2022*, RISK (Mar. 14, 2023), <https://www.risk.net/risk-quantum/7956243/like-svb-five-other-us-lenders-reported-negative-nii-growth-in-2022#:~:text=Ally%20Financial%2C%20Customers%20Bancorp%2C%20First,a%20Risk%20Quantum%20analysis%20shows> [<https://perma.cc/6MB8-KX4R>] (reporting that “Ally Financial, Customers Bancorp, First Foundation, Morgan Stanley and PacWest saw NII growth of between -3% and -15% in the fourth quarter of 2022”); Lorenzo Migliorato, *Ahead of Collapse, SVB's Interest Expense Climbed 1,700%*, RISK (Mar. 13, 2023) [hereinafter Migliorato, *Ahead of Collapse*], <https://www.risk.net/risk-quantum/7956233/ahead-of-collapse-svbs-interest-expense-climbed-1700#:~:text=Silicon%20Valley%20Bank%20struggled%20to,the%20year%2C%20to%20%24719%20million> [<https://perma.cc/PK3M-YTH7>] (noting that SVB Bank struggled with high interest rates, even before its collapse, and its “[i]nterest expenses rose at an average rate of 164% between Q2 and Q4 2022, for a cumulative 1,698% increase . . . to \$719 million”); Philip Alexander, *Bank Runs Prompt Rethink of IRRBB Deposit Models*, RISK (Apr. 26, 2023),

Furthermore, the bank's authorizing legislation should address the lack of access to inter-state banking services. One way to do so is by partnering with a FinTech company such as Banked,<sup>130</sup> which has broad experience working with financial institutions, especially when these sub-national financial institutions seek to create new pay-by-bank services.<sup>131</sup> Pay-by-bank, or real-time transactions between any two banks within the geographic boundaries of the United States, may eventually replace credit and debit cards as the very best way to carry out interstate transactions.<sup>132</sup>

Within this context, a state-owned cannabis industry bank may be created by carrying out several post-charter activities. These activities, which are similar to the ones that are required of national banks and similar institutions, may include initial capitalization, organization, site and management selection plans, incorporation, and pre-opening examinations for new institutions.<sup>133</sup>

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<https://www.risk.net/risk-management/7956580/bank-runs-prompt-rethink-of-irrb-deposit-models> [https://perma.cc/BB4S-PW4X] (noting that banks are reevaluating their asset and liability models, especially following Silicon Valley Bank's recent bank run); Joshua Walker, *HTM Securities Hit \$2.5trn at US Banks in 2022*, RISK (Mar. 27, 2023), <https://www.risk.net/risk-quantum/7956308/htm-securities-hit-25trn-at-us-banks-in-2022> [https://perma.cc/79YQ-NSX5] (reporting that "[t]hree US banks held more than 70% of their securities classified as held-to-maturity (HTM) at the end of [2022], a similar proportion to what Silicon Valley Bank (SVB) reported before its collapse"). With 74%, Bank of America has the second largest share of HTM at the end of 2022. *Id.*

130. See Brad Goodall, *Banked + Bank of America Partner to Offer Pay by Bank*, BANKED (Feb. 13, 2022), <https://banked.com/articles/banked-bank-of-america-partnership-pay-by-bank> [https://perma.cc/439W-SZ8Q] ("We are really delighted to be partnering with Bank of America . . . Pay by Bank : allows customers to pay online via a bank account, streamlining checkout and avoiding the need for financial data entry and providing a secure way to pay.").

131. See, e.g., *Bank of America Launches Online Payment Solution, "Pay By Bank,"* BANK AM. (Feb. 14, 2022, 8:00 AM), <https://newsroom.bankofamerica.com/content/newsroom/press-releases/2022/02/bank-of-america-launches-online-payment-solution---pay-by-bank--.html> [https://perma.cc/SFG5-598W] ("Pay by Bank transactions, which are based on the concept of Open Banking, take place in real-time and require no credit or debit card details."); see also *Giving You the Freedom to Spend*, AEROPAY, <https://www.aeropay.com/personal> [https://perma.cc/JD29-GYR2] ("Link to your bank to pay and leave the limits of cash or cards behind.").

132. See, e.g., Joshua Franklin, *How JPMorgan's Plan to Kill Credit Cards Split the Bank*, FIN. TIMES (Sept. 22, 2022), <https://www.ft.com/content/f6d8d454-2413-4f2b-945d-825d0a68730b> [https://perma.cc/TF63-2QBP] ("Facing growing pressure from nimbler fintechs, the chief executive of the biggest US bank [JP Morgan] pushed the leaders of his two largest divisions to put aside any differences and collaborate on a new payments processing system."). In light of the SVB and Signature Bank failures in early 2023, some observers believe that bank deposit may be riskier than less traditional alternatives. See, e.g., Jon Hill, *CFPB's Chopra Scopes Nonbank Risks Amid Banking Turmoil*, LAW360 (Mar. 29, 2023, 4:55 PM), <https://www.law360.com/articles/1591297/cfpb-s-chopra-scopes-nonbank-risks-amid-banking-turmoil> [https://perma.cc/YT4G-7RJE] (quoting Consumer Financial Protection Bureau Director Rohit Chopra as noting that banking regulators have to accept that P2P's "faster communication is an opportunity and a risk").

133. Cf. SCOTT, *supra* note 15, at 19.

### *C. Potential Benefits of Creating a State-Owned Cannabis Industry Bank*

In light of this essay's analysis, and in keeping with the requirements of a yet-to-be enacted authorizing statute that draws upon elements of the Bank of North Dakota Act, a valid state license or charter may be issued for cannabis industry banks that exclusively draw on a sub-national grant of authority. Licensing requirements also could be informed by more recent legislative enactments, such as the Wyoming Special Purpose Depository Institutions Charter<sup>134</sup> or the New York Limited Purpose Trust Company Charter.<sup>135</sup> By doing so, states could create their own sub-national financial institutions that avoid actual conflicts between federal and state cannabis law.

Having identified the positives and negatives of creating state-owned cannabis industry banks, it is clear that these limited subject matter institutions could yield a range of benefits. For example, the real parties to a cannabis trade may benefit through some increased assurance that their cannabis sale contract will be acknowledged and performed. This increased assurance also may help buyers and sellers in the cannabis industry to improve their liquidity and/or credit ratings.

The owners of cannabis industry businesses or businesses that provide support services to the cannabis industry also could benefit from the creation of cannabis industry banks. Any such benefits are likely to arise from the fact that owners of businesses that handle the proceeds from cannabis trades have an increased likelihood of receiving the benefit of their downstream bargains with actual participants in the legal cannabis industry. This increased likelihood of performance may increase service provider confidence in the cannabis industry and attract more investment.

Lastly, unrelated third parties could benefit from the existence of cannabis industry banks. These third-party benefits may include some protection from governmental failures and related externalities.<sup>136</sup> An example of such externalities includes the cost of defending against lawsuits, which arise when a regulated party alleges that a government

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134. Special Purpose Depository Institution, WYO. STAT. ANN. § 13-1-101(xvi) (2019).

135. N.Y. BANKING LAW § 5050 (McKinney 1997).

136. See CLIFFORD WINSTON, BROOKINGS JOINT CTR. FOR REGUL. STUD., GOVERNMENT FAILURE VERSUS MARKET FAILURE: MICROECONOMICS POLICY RESEARCH AND GOVERNMENT PERFORMANCE 2-3 (2006) (noting that governments failures arise "when government has created inefficiencies because it should not have intervened [in a particular market] in the first place or when [that government] could have solved a given problem . . . more efficiently . . . by generating greater net benefits").

treated similarly situated individuals in a non-standard way without adequate justification under a neutral law of general applicability.<sup>137</sup>

#### *D. Potential Challengers to the Creation of Cannabis Industry Banks*

Despite the multiple benefits of cannabis industry banks, interested parties still may oppose the creation of these state-owned and operated financial institutions. Potential detractors may include good governance groups such as the Illinois Policy Institute.<sup>138</sup> Such parties, for example, may seize upon the fact that the general public is not fully protected from government failures.<sup>139</sup>

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137. See generally Zachary Nelson, *If It Looks Like a Duck: Equal Protection, Selective Prosecution, and Geographic Differences in the Federal Prosecution of Marijuana Crimes Under the Controlled Substances Act*, 23 LEWIS & CLARK L. REV. 1007, 1045–50 (2019).

138. See Ill. Pol’y Inst., *What Does the Illinois Policy Institute Do?*, ILL. POL’Y, <https://www.illinoispolicy.org/faqs/who-funds-the-illinois-policy-institute/> [https://perma.cc/FL5L-RNKM] (explaining that the Illinois Policy Institute seeks to “define the challenges facing Illinois residents, study how public policy reforms can help and then craft positive, innovative solutions based on free enterprise principles”).

139. The aforementioned debate was fueled by the recent issues faced by SVB, Signature Bank, and First Republic Bank. See Maureen Farrell & Jeanna Smialek, *First Republic Bank Enters New Free Fall as Concerns Mount*, N.Y. TIMES (Apr. 25, 2023), <https://www.nytimes.com/2023/04/25/business/first-republic-bank-stock-price.html> [https://perma.cc/PSD5-Y7VJ] (reporting that more than \$102bn in First Republic’s deposits were withdrawn, in the first quarter alone, which constituted more than 50% of this financial institution’s \$176bn in on-hand deposits); see also Joshua Franklin, *Big US Banks Expected to Report Deposit Flight in Upcoming Earnings*, FIN. TIMES (Apr. 11, 2023), <https://www.ft.com/content/4b8ed13a-e4c5-40a5-b15e-afa73e74dd10> [https://perma.cc/6WLL-W3XW] (noting that customers withdrew almost \$100bn from ‘Big Four’ retail banks in the first quarter of 2023). Other contributing factors included poor asset and liability management. These management issues should not be confused with what some commentators have criticized as risks arising from financial institutions with a limited subject matter. See, e.g., Mark Vandeveld, Antoine Gara, Joshua Franklin, Colby Smith & Tabby Kinder, *Silicon Valley Bank: The Multiple Warnings That Were Missed*, FIN. TIMES (Apr. 23, 2023), <https://www.ft.com/content/1795b4a7-65b0-4053-a328-3c46c525ad71?shareType=nongift> [https://perma.cc/SKL3-H4U2] (describing how more than a year before the bank failed regulators and advisers identified the possibility of SVB failing due to what was listed on this bank’s balance sheet). Push for deregulation after the 2007 and 2008 financial crisis may have also significantly contributed to the failure of these banks. See, e.g., David Enrich, *Back-to-Back Bank Collapses Came After Deregulatory Push*, N.Y. TIMES (Mar. 13, 2023), <https://www.nytimes.com/2023/03/13/business/signature-silicon-valley-bank-dodd-frank-regulation.html> [https://perma.cc/5587-NAQ7] (describing the rationale behind the federal government’s change to stress testing, which directly benefited Signature Bank); see also Todd Phillips, *How 2018 Regulatory Rollbacks Set the Stage for the Silicon Valley Bank Collapse, and How to Change Course*, ROOSEVELT INST. (Mar. 15, 2023), <https://rooseveltinstitute.org/2023/03/15/how-2018-regulatory-rollbacks-set-the-stage-for-the-silicon-valley-bank-collapse-and-how-to-change-course/> [https://perma.cc/3PKS-HS2Y] (describing the weakening of the Volcker Rule and other regulatory exemptions); Stephen Neukam, *Warren: Powell Took a Flamethrower to Bank Regulations*, HILL (Mar. 19, 2023, 8:26 AM), <https://thehill.com/homenews/sunday-talk-shows/3907265-warren-powell-took-a-flamethrower-to-bank-regulations/> [https://perma.cc/R4WZ-TGCE] (noting how Federal Reserve Chair Jerome Powell was responsible for rolling “back some core regulatory measures, including stripping some of the tools” provided for in the Dodd-Frank banking reform package); MICHAEL S. BARR, BD. OF GOVERNORS OF THE FED. RESRV., REVIEW OF THE FEDERAL RESERVE’S SUPERVISION AND REGULATION OF SILICON VALLEY BANK 9



A second category of potential opponent may withhold support simply because the status quo is preferred to a future that includes state-owned cannabis industry banks. Any such detractors are likely to benefit from the idea that non-state and privately owned financial service entities should receive the lion-share of economic and social benefits that arise from state action. Examples of these possible opponents may include existing federally regulated financial services institutions.

A final group of detractors may question the wisdom of creating new government-owned and operated entities. Members of this group may argue that there is too much government already. Potential opponents could be drawn from anti-tax groups such as Americans for Tax Reform.<sup>140</sup>

#### *E. Viable Implementation Plan for a State-Owned Cannabis Industry Bank*

Potential challenges with creating a state-owned cannabis industry bank may be overcome in a variety of ways. One viable option is for these limited subject matter institutions to provide additional and different benefits from existing banks. Specifically, state-owned and operated cannabis banks could help their home states to make better use of their scarce public resources. For example, each institution may do so by limiting unnecessary discretion or conflicts of interest.

In addition, in terms of risk management, a state-owned bank may prove to be a safer option than otherwise similarly situated financial institutions. For example, it may be easier to put into place more effective asset and liability management models.<sup>141</sup> Ideally, such models should include mandatory reverse stress-testing<sup>142</sup> and sensitivity analysis.<sup>143</sup> These types

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(2023) (concluding that “the supervisory approach at SVBFG was too deliberative and focused on the continued accumulation of supporting evidence in a consensus-driven environment”); Jeanna Smialek, *Fed Slams Its Own Oversight of Silicon Valley Bank in Post-Mortem*, N.Y. TIMES (Apr. 28, 2023), <https://www.nytimes.com/2023/04/28/business/economy/fed-silicon-valley-bank-failure-review.html> [<https://perma.cc/44LP-KNFZ>] (reporting that “[a] sweeping – and highly critical – review conducted by Michael S. Barr, the Fed’s vice chair for supervision, identified lax oversight of the bank and said its collapse demonstrated ‘weaknesses in regulation and supervision’”).

140. See *About*, AMERICANS TAX REFORM, <https://www.atr.org/about/> [<https://perma.cc/HD58-2PPH>] (explaining that Americans for Tax Reform believes “government’s power to control one’s life derives from its power to tax. [And this group, thus, believes] that power should be minimized”).

141. See *Asset and Liability Management (ALM)*, CORPORATE FIN. INST. (May 28, 2023), <https://corporatefinanceinstitute.com/resources/management/asset-and-liability-management-alm/> [<https://perma.cc/UZL7-JKZC>].

142. See Metin Epozdemir, *Reverse Stress Testing: A Critical Assessment Tool for Risk Managers and Regulators*, S&P GLOB. (Aug. 10, 2021), <https://www.spglobal.com/marketintelligence/en/mi/research-analysis/reverse-stress-testing-assessment-tool-risk-managers-regulators.html> [<https://perma.cc/SC3P-QFLR>].

143. See CFI Team, *What Is Sensitivity Analysis?*, CORPORATE FIN. INST. (Apr. 21, 2023), <https://corporatefinanceinstitute.com/resources/financial-modeling/what-is-sensitivity-analysis/> [<https://perma.cc/LHB5-3BLE>].

of analyses are useful for identifying certain “hidden risks” that do not directly arise from interest rate increases.<sup>144</sup>

Cannabis industry banks also may highlight some of the hidden problems with the financial services status quo.<sup>145</sup> One example is the fact that federal deposit insurance is not the only way to limit the harms that arise from bank runs, as cannabis industry banks could provide the exact same type of protection by drawing on the full faith and credit of their home states.<sup>146</sup> By doing so, they draw attention to the possibility of moral hazard in the provision of federal deposit insurance.<sup>147</sup>

### CONCLUSION

The legal cannabis trade is the fastest growing industry in the United States.<sup>148</sup> In 2019, about 48.2 million Americans used the drug at least

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144. See, e.g., Migliorato, *Ahead of Collapse*, *supra* note 129 (noting that SVB Bank struggled with high interest rates, even before its collapse, and its “[i]nterest expenses rose at an average rate of 164% between Q2 and Q4 2022, for a cumulative 1,698% increase . . . to \$719 million”).

145. A good example is the debate about the CFPB’s new “open banking” rule. Under section 1033 of the Dodd-Frank Act, the CFPB is charged with better protecting bank customers’ financial data. One goal of the open banking rule is slowing down “screen scraping,” which allows consumers to provide their financial data more easily to interested third parties. Such a transfer may encourage the provision of cheaper, better, and more financial services. See, e.g., Evan Weinberger & Andrea Vittorio, *Small Banks Urge CFPB to Phase in Open Banking Tech Requirements (Correct)*, BLOOMBERG L. (Jan. 30, 2023), <https://news.bloomberglaw.com/banking-law/small-banks-urge-cfpb-to-phase-in-open-banking-tech-requirements> [<https://perma.cc/4N8H-BXBR>] (noting the FTA’s comment that “[c]onsumers . . . enjoy the greatest benefit from Section 1033 to the extent that it provides consumers a holistic ability to . . . shop for the broadest range of financial products and services”).

146. See also Paul J. Davies, *The Battle Over Deposit Insurance Is Just Beginning*, BLOOMBERG (Apr. 2, 2023, 11:00 PM), <https://www.bloomberg.com/opinion/articles/2023-04-03/after-svb-the-battle-over-deposit-insurance-is-just-beginning#xj4y7vzkg> [<https://perma.cc/VYG7-VQR7>] (noting that the FDIC is rethinking deposit insurance and how it is funded); James Politi & Joshua Franklin, *White House Pressed to Expand Deposit Guarantee to Steady Banks*, FIN. TIMES (Mar. 19, 2023), <https://www.ft.com/content/8c132c3e-be8d-452d-bf2c-1273798620fe> [<https://perma.cc/8B3L-538E>] (quoting Senator Elizabeth Warren as noting that she thinks lifting the deposit insurance cap of \$250,000 is a “good move” and that “[s]mall businesses need to be able to count on getting their money to make payroll, to pay the utility bills”); cf. BARR, *supra* note 139, at 2 (recognizing that “the combination of social media, a highly networked and concentrated depositor base, and technology may have fundamentally changed the speed of bank runs,” rather than a failure to make use of federal deposit insurance).

147. See *Second-Degree Moral Hazard*, ECONOMIST (Mar. 2, 2017), <https://www.economist.com/finance-and-economics/2017/03/02/second-degree-moral-hazard#> [<https://perma.cc/BW6F-3VV8>] (describing moral hazard as a problem that arises when “[p]eople behave differently [because] they do not face the full costs or risks of their actions: deposit insurance makes customers less careful about picking their bank, for example”).

148. See Matt Ferner, *Here’s How Fast the Marijuana Industry Is Growing*, In *5 Charts*, HUFFPOST (Jan. 29, 2015, 5:00 PM), [https://www.huffpost.com/entry/marijuana-industry-growth-charts\\_n\\_6565604](https://www.huffpost.com/entry/marijuana-industry-growth-charts_n_6565604) [<https://perma.cc/9Y4U-8QER>] (explaining that “[l]egal marijuana is the fastest-growing industry in the United States, according to a new report from . . . The ArcView Group, a cannabis industry investment and research firm . . . in Oakland, California”).

once.<sup>149</sup> As such, it is easy to see why the legal cannabis trade may generate total revenues exceeding \$30 billion in Fiscal Year 2022 alone.<sup>150</sup>

One inconvenient truth, however, is that the parties to any cannabis trade may face a range of difficulties due to conflicts between federal and state laws. These difficulties include the fact that many financial institutions are reluctant to handle any cannabis proceeds. One reason is that a lack of alignment in terms of federal and state laws, at least when compared to otherwise similarly situated U.S. infant industries, drives up the cost of doing business in many cannabis industries.<sup>151</sup>

As a result, states that purport to authorize cannabis trades may need to intervene. The simplest way to do so, and thereby increase access to financial services in this infant industry, is by creating a new state-owned cannabis industry bank. Such a bank may be created, insofar as it would be possible, exclusively under state laws to avoid any conflict with federal cannabis laws.

There also are additional reasons why U.S. states may want to create their own cannabis industry banks. First, states are responsible for the creation of their in-state cannabis industries and should receive the lion-share of future economic benefits arising from ostensibly legal cannabis trades. Second, these sub-national jurisdictions likely incurred significant costs in creating these infant industries and are justified in receiving a robust return on their earlier investments. Finally, states could use any returns to compensate third parties that are harmed by cannabis trading within their boundaries such as African Americans disproportionately subjected to pretextual stops.<sup>152</sup>

Within this context, states should take care to avoid situations that reduce the effectiveness of cannabis industry banks. For example, these sub-national governments may limit conflicts of interest. One way to do so could be to set clear administrative rules, especially with respect to how bank officials interact with interested parties, in order to limit the possibility of corruption. An example of how to set clear legal rules is what Illinois did in

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149. See *Marijuana and Public Health*, *supra* note 1.

150. See BURNS & WILCOX, *supra* note 2 (explaining that “[l]egal cannabis sales in the U.S. could exceed \$30 billion in 2022”).

151. See *Infant Industry*, CAMBRIDGE DICTIONARY, *supra* note 4 (defining the term to mean “a new industry that is in its earliest stage of development”).

152. See Douthat, *supra* note 5 (“[T]here is . . . no good evidence so far that legalization reduces racially discriminatory patterns of policing and arrests. . . . [In fact, a recent study asserts that] . . . cops often use marijuana as a pretext to search someone they suspect of a more serious crime, and they simply substitute some other pretext when the law changes, leaving arrest rates basically unchanged.”). One way to provide compensation is through the provision of free bank accounts, grant funding, and direct lending.

structuring its Accelerated Pension Benefit Payment Program,<sup>153</sup> which draws its inspiration from a recent U.S. law review article.<sup>154</sup>

Sub-national governments that seek to create their own cannabis industry banks also may want to avoid any unjustified use of their scarce public sector resources. By doing so, ideally through the use of internal cannabis bank controls and outside regulators, states may increase the popularity of these limited subject matter institutions and avoid situations that limit their effectiveness. One example of a case in point is what North Dakota did with its namesake bank.

Finally, states should assure the long-term viability of cannabis industry banks. A good way to do so is by shielding these financial institutions from collateral attacks. Among the options for doing so is to codify the legal rights, and obligations, of each cannabis industry bank through a state constitutional amendment. No U.S. states, at least as of this writing, have constitutionally protected their financial institutions. Examples of other governments that have done so are Mexico, Poland, Sweden, and

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153. See ILL. ADMIN. CODE tit. 80, § 1540.395 (2022).

154. See Randall K. Johnson, *Why U.S. States Need Pension Waiver Credits*, 40 S. ILL. U. L.J. 203, 206–07 (2016) (“This new tax expenditure concept, which is described for the first time in this article, achieves its goal by providing fresh consideration for each of the parties [to a valid public pension contract]. This additional consideration takes two forms: a new tax credit allocation (i.e., this tax expenditure provides early access to retirement benefits, which would otherwise be accessible upon retirement, and thereby provides fresh consideration for public employees) and the right to discontinue offering defined-benefit pension plans (i.e., the waiver of this legal duty, which would otherwise need to be discharged, serves as fresh consideration for public employers). Because this fresh consideration is not tied to any pre-existing duty, and meets every other requirement, Pension Waiver Credits resolve the fresh consideration dilemma for public pension contracts.” (footnotes omitted)); ILL. ADMIN. CODE tit. 80, § 1540.395(a) (2022) (“This Section establishes policies specific to SERS concerning the Accelerated Pension Benefit Payment Options authorized by Sections 14-147.5 and 14-147.6 of the Illinois Pension Code (Code) [40 ILCS 5].”). But some third parties refuse to recognize the value of this reform, or other viable options that are less-than-comprehensive, unless that option is their idea. See, e.g., Adam Schuster & Patrick Andriesen, *Illinois May Borrow \$1B for Pension Buyouts*, ILL. POL’Y INST. (Feb. 9, 2022), <https://www.illinoispolicy.org/illinois-may-borrow-1b-for-pension-buyouts/> [<https://perma.cc/9GMU-9EA6>] (warning that the Accelerated Pension Payment Program is “a disappointment and will do little to ease Illinois’ worst-in-the-nation pension crisis” and advocating for a partial reform option that includes a new constitutional amendment). The experts proposed this new amendment even though it is not likely to be ratified, it is more costly, and it would address an even smaller number of Illinois’ current pension issues. As of this writing, policymakers have not been persuaded by such experts and continue to offer the Accelerated Pension Benefit Payment Program. See Greg Hinz, *This Partial Pension Patch Looks Likely to Be Renewed: Springfield Memo*, CRAIN’S CHI. BUS. (Jan. 27, 2022, 7:10 AM), <https://www.chicagobusiness.com/juice/illinois-pension-payout-program-likely-be-renewed-juice-springfield-memo> [<https://perma.cc/PF5R-PLPW>] (“It looks like state lawmakers are preparing to roll over one of the few initiatives that has taken a decent bite out of state’s huge unfunded pension liability. Pending in the House—and on a ‘short debate’ fast track to passage—is a measure . . . that would renew a pilot program in which retirees covered by Illinois’ four big retirement funds can cash out early, taking a lump sum up front in lieu of either their entire pension or, more typically, annual guaranteed 3% compounded cost of living increases.”).

Switzerland.<sup>155</sup> The European Union also has taken similar steps, although the way of protecting its state-owned bank is structured a bit differently.<sup>156</sup>

But regardless of how sub-national jurisdictions choose to protect their investments in cannabis banks, it is clear why states may seek to do so. First, cannabis industry banks encourage compliance with federal, state, and local laws. These limited subject matter institutions also help states to make better use of dead capital.<sup>157</sup> Lastly, in bringing about various efficiency gains, cannabis banks limit transaction costs that arise from differences between federal and state laws.

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155. Org. for Econ. Coop. & Dev., *Constitutions in OECD Countries: A Comparative Study: Background Report in the Context of Chile's Constitutional Process*, OECD LIBR. (Feb. 28, 2022), <https://www.oecd-ilibrary.org/sites/97bb0aad-en/index.html?itemId=/content/component/97bb0aad-en#section-d1e16763> [<https://perma.cc/F356-63G7>] (“In general, primary laws stipulate the specifics of the mandate and responsibilities of central banks. In Mexico, Poland, Sweden and Switzerland, these are stated explicitly in the constitution.”).

156. *Id.* (“Similarly, in the euro area, these objectives are stated in TFEU [or Treaty On The Functioning Of The European Union].”).

157. See Johnson, *supra* note 154, at 211 n.61 (explaining that “‘dead capital’ is the idea that property has little-or-no-value when it cannot be made liquid”); HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* 5–6 (2000).