Banking on Guns n’ Drugs: Social Policy Meets Financial Services (Abstract)

This panel will explore the connection between banking relationships and policy views on social issues.

Today, banks and other financial institutions are at the center of controversies regarding whether they should take public positions on issues such as guns, cannabis, and climate change. While some argue that banks should serve all lawful businesses equally and avoid political activism, others take the position that banks should act with a “conscience” and avoid relationships with certain lawful industries. These concerns are amplified by the fact that depository institutions operate in a regulated environment with high barriers to entry, and receive significant government benefits such as a low cost of funds.

In the cannabis industry, although legal in some states, the prohibition under federal law makes large financial institutions unwilling to do business with marijuana-related businesses. Moreover, the major credit card networks – including Visa – prohibit transactions involving marijuana. This puts many businesses across the supply chain in the difficult position of relying on cash. In the absence of a legislative solution from Congress, federal and state agencies have taken a number of different approaches. The Obama administration issued the (since rescinded) Cole Memorandum directing federal prosecutors not to focus federal resources prosecuting individuals complying with state law in “jurisdictions that have enacted laws legalizing marijuana in some form and that have also implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale and possession of marijuana.” However, this policy of non-enforcement did little to assuage the fears of large financial institutions, in part because the Memorandum could be withdrawn at any time, leaving such institutions vulnerable to prosecution or regulatory enforcement action.

At the state level, a small number of credit unions are willing to provide banking services to certain business in the marijuana industry. But even when deposit services are available, they are typically more expensive and credit unions are unwilling to provide other services such as lines of credit. Moreover, in California, there has been proposed legislation to create a limited-purpose banking charter to provide depository services to licensed marijuana businesses. Nonetheless, federally insured institutions still risk violating federal money laundering laws by receiving funds that are known to have been derived from the sale of marijuana.

Unlike the controversy surrounding marijuana business which stems from a conflict between state and federal law, banks are also under increasing pressure to cut off ties with private prisons, payday lenders, fossil fuel companies, and gun manufacturers operating in full compliance with state and federal law. Three of the largest banks in the country recently announced that they will stop lending to companies that run private prisons and detention centers. Other banks are rethinking their relationships with gun manufacturers. Sometimes the decision is couched in terms of credit risk or reputational risk, while in other instances it stems from the bank’s sense of social responsibility. In all cases these decisions have followed a rising tide of public sentiment turning against the particular industry.
Another politically charged issue affecting the banking industry is climate change. Regulators in Europe are beginning to look at the risks posed by climate change through a new lens. Central banks have formed working groups to evaluate proposals such as whether banks should stress test their loan portfolios against the impact of rising sea levels, extreme weather events, and prolonged droughts. The concern is that managing the effects of climate change is crucial to the safety and soundness of a banking institution. Domestically, regulators are approaching the issue with a more measured response. Federal banking regulators have, in response to Congressional inquiries, stated that banks are not required to conduct climate change-related stress tests. The unpredictability and uncertainty of weather forecasts can make climate change difficult to incorporate into a risk management framework.

Nonetheless, certain U.S. regulators are taking bolder approaches. A Commissioner on the Commodity Futures Trading Commission plans to produce a study of how climate change can affect the financial sector, with a specific focus on how extreme weather events can create volatility that leave financial institutions unable to effectively hedge risks through futures contracts.

This panel will address legal and policy concerns and responses at both state and federal levels. These concerns include anti-money laundering considerations, due diligence of customer relationships, safety and soundness, and reputational concerns. Moreover, this panel will explore the policy question of whether banking services should be provided to all lawful businesses on a nondiscriminatory basis, or whether private firms have an obligation to exercise corporate and social responsibility.