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SESSION 3

Banking the Cannabis Industry

Challenges and Opportunities Faced by Financial Institutions Banking
Marijuana-related Businesses (MRBs)

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Introduction

WELCOME

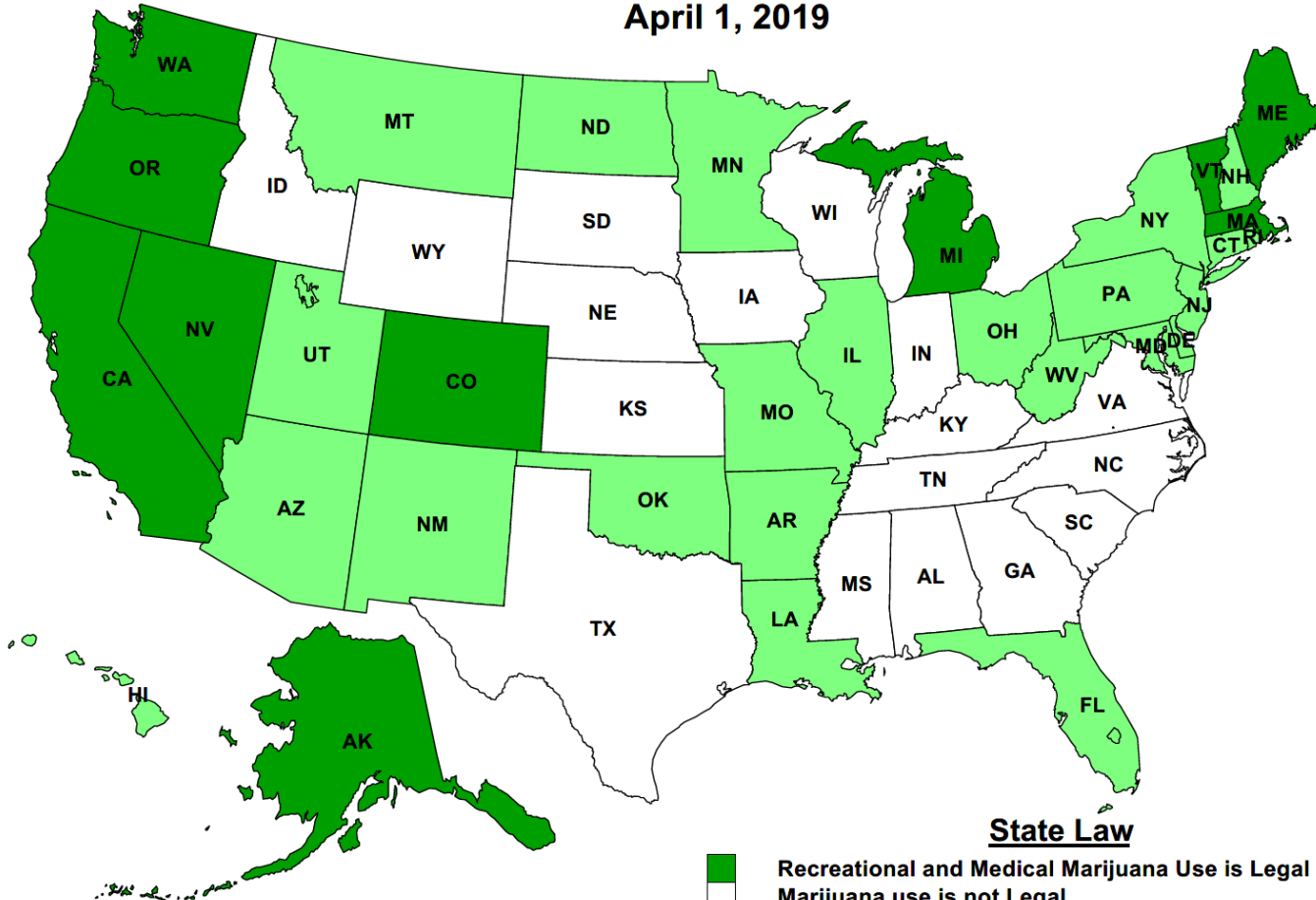
MAINE CANNABIS INDUSTRY

Marijuana: The Legal Landscape

- Grey Market Industry
- 33 states and D.C. currently have laws legalizing marijuana in some form
- Illegal under federal law
 - Under the Controlled Substances Act (CSA), marijuana is classified as a Schedule I drug, which means that the federal government views it as highly addictive and having no medicinal value.

States with Legalized Marijuana

American Nonsmokers' Rights Foundation
April 1, 2019



To see a map of state and local laws prohibiting smoking and vaping marijuana, visit <https://no-smoke.org/wp-content/uploads/pdf/marijuana-smokefree-laws-map.pdf>

State Law

- Recreational and Medical Marijuana Use is Legal
- Marijuana use is not Legal
- Medical Marijuana Use, but not Recreational, is Legal

Note: In total, medical marijuana use is legal in 33 states.

The Shift in Public Opinion

- In 1995, the year before California became the first state to legalize medical marijuana, 25% of Americans polled in a Gallup survey favored nationwide legalization of marijuana.
- By comparison, in Gallup's October, 2018 survey, two out of three Americans polled favored legalization.



**So why do MRBs have such trouble
accessing banking services and payment
systems?**

WHAT'S THE BIG DEAL?

CSA Provisions Applicable to Financial Institutions (FIs)

- CSA prohibits conspiring to engage in or aiding and abetting manufacture and distribution of Schedule I drugs.
 - An individual who has knowledge that the CSA has been violated and assists may be charged as an accessory after the fact or with aiding and abetting.

US Anti-Money Laundering (AML)

- The Money Laundering Control Act prohibits any person from knowingly conducting certain financial or monetary transactions involving proceeds of “specified unlawful activities,” which is defined to include proceeds from marijuana-related violations of the CSA.
- There is no safe harbor for banking MRBs that are in compliance with state law.

Bank Secrecy Act (BSA)

- Requires FIs to establish anti-money laundering programs and report suspicious activity to FinCEN
- BSA compliance program must include risk-based procedures for conducting ongoing customer due diligence to identify suspicious activity
- FIs must report illegal/suspicious activity and all cash transactions of more than \$10,000 per day by any person`

The 2013 Cole Memo

- DOJ Policy written by former US Deputy AG James M. Cole and issued to all US Attorneys (Cole Memo)
- Makes clear that marijuana remains illegal under CSA *but* instructed federal prosecutors to focus enforcement efforts on 8 priority areas

The Cole Memo: Eight Enforcement Priorities

1. Preventing the distribution of marijuana to minors
2. Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels
3. Preventing the diversion of marijuana from states where it is legal under state law in some form to other states
4. Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity

The Cole Memo: Eight Enforcement Priorities

5. Preventing violence and the use of firearms in the cultivation and distribution of marijuana
6. Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use
7. Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands
8. Preventing marijuana possession or use on federal property

The 2014 Cole Memo

- Reiterated the 8 enforcement priorities
- **Clarified that:**
 - Provisions of AML and BSA remain in effect with respect to MRBs
 - Financial transactions involving illegal MRB proceeds can form the basis of prosecution
 - **BUT**
 - Prosecution of FIs for offering financial services to MRBs with activities that do not implicate any of the 8 enforcement priorities may not be appropriate

2014 FinCEN Guidance: Customer Due Diligence

- Clarified how FIs can provide services to MRBs consistent with their BSA obligations
- **Provides that FIs considering providing financial services to MRBs must have a customer due diligence compliance program in place that, among other things, includes:**
 - Verifying with state authorities whether the business is duly licensed
 - Ongoing monitoring for license violations and suspicious activity
- **The most important considerations an FI should consider are whether the MRB implicates one of the 8 Cole Memo enforcement priorities and whether the MRB is in compliance with state marijuana laws.**

2014 FinCEN Guidance: SAR Filings

- Also clarifies that the obligation to file SARs is unaffected by any state law that legalizes MRB activity
- Outlines three types of SAR Filings for MRBs based on FI's due diligence:
 - **Marijuana Limited** – No violation of state marijuana laws and none of the 8 Cole Memo priorities are implicated
 - **Marijuana Priority** – One or more of the Cole Memo priorities are implicated or the MRB is in violation of a state marijuana law
 - **Marijuana Termination** – FI deems it necessary to terminate relationship with MRB in order to maintain effective AML compliance; if FI becomes aware of MRB moving money to another FI, FinCEN encourages voluntary info sharing to alert new FI of potential illegal activity
- Identifies Red Flags to help FIs distinguish Marijuana Priority SARs

The 2018 Sessions Memo

- Then-AG Jeff Sessions issued a one-page memo rescinding the 2013 and 2014 Cole Memos
- Instructed federal prosecutors in deciding which MRB-related activity to prosecute to **“follow well-established principles that govern all federal prosecutions,”** including:
 - Federal law enforcement priorities set by the AG
 - Seriousness of the crime
 - Deterrent effect of the criminal prosecution
 - Cumulative impact of particular crimes on the community

The 2018 Sessions Memo: What a Mess

- **Immediately raised uncertainty as to whether FinCEN guidance remained in place**
 - It does
 - Today, the 2014 FinCEN guidance still applies to both the SAR reporting structure and remains the operative guidance for FIs to meet BSA requirements.
- **Also raised uncertainty with respect to how individual prosecutors would respond**

Attorney General William Barr

- In confirmation hearings in January 2019, then U.S. Attorney General nominee, Bill Barr, said he would "not go after" marijuana companies in states where cannabis is legal.
- Signals potential return to Cole Memo enforcement priorities

Rohrabacher-Blumenauer Amendment

- Prohibits DOJ from spending money prosecuting MRB activities that are legal under state medical marijuana laws
- First enacted in 2014
- As budget amendment, it must be approved every year
- Was renewed on February 15, 2019
 - **BUT . . .** President Trump's attached signing statement leaves open the possibility that Trump will use his executive authority to enforce federal law

Banking MRBs in Compliance with Federal Guidelines

- There is no safe harbor from federal prosecution concerning marijuana enforcement under the CSA.
- As a matter of policy and practice, prosecutors and regulators have focused attention on prosecutorial priorities outlined in the Cole Memo, despite the Sessions Memo.
- **Why are FIs still reluctant to offer financial services to MRBs?**
 - FIs are responsible to regulators who are independent from the DOJ and the executive branch.
 - The policy and practice of no or limited federal enforcement could change at any time.

The 2018 Farm Bill

- **Removed hemp and CBD from Schedule I of the Controlled Substances Act**
- No longer an illegal substance under federal drug enforcement laws
- **Hemp** = Cannabis (*Cannabis sativa L.*) and derivatives of cannabis with extremely low (less than 0.3 percent on a dry weight basis) concentrations of the psychoactive compound delta-9-tetrahydrocannabinol (THC)

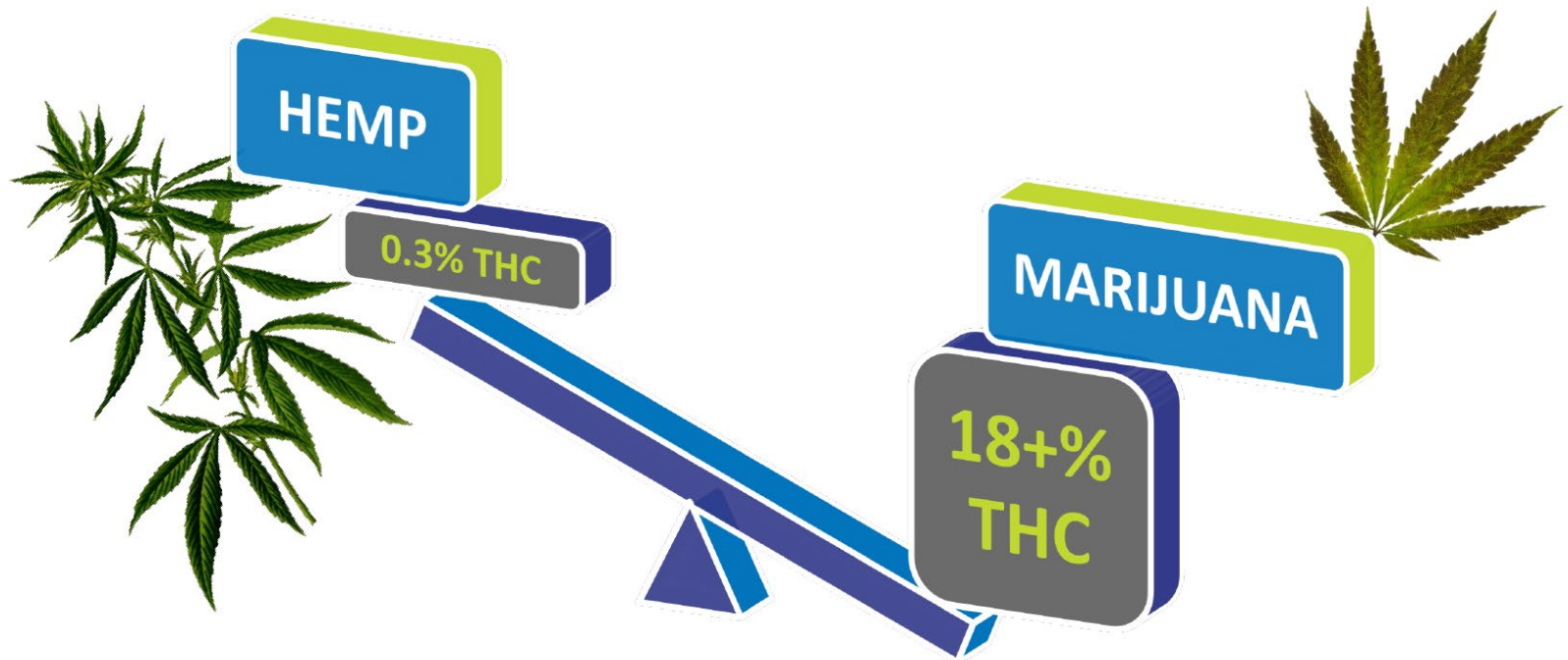
2018 Farm Bill Definition of Hemp

“SEC. 297A. DEFINITIONS.

“In this subtitle:

“(1) HEMP.—The term ‘hemp’ means the plant *Cannabis sativa* L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis.

The Distinction Between Hemp and Marijuana



Removal of Hemp from the Controlled Substances Act

- **Companion system of federal and state licensing**
 - If state has federally approved plan, need state license
 - If state does not have plan approved by the feds, production in that state is subject to federal rules and licensing
 - Federal rules and licensing have not been developed yet
- **Important aspects of required state plans**
 - Location of the land
 - Licensing scheme
 - Testing procedures to check THC content
 - Procedures for disposal of plants with excess THC content
 - Annual and random inspections of hemp producers to test THC levels
 - No federal preemption of more stringent state laws

Removal of Hemp from the Controlled Substances Act

- Nothing in the Act affects or modifies the Federal Food Drug and Cosmetic Act or impacts the FDA's ability to promulgate regs and guidelines that relate to the production of hemp under the Federal Food Drug and Cosmetic Act.
- No state is allowed to prohibit the interstate commerce of legally compliant hemp.
- USDA's goal is to have regulations in place by Fall 2019 in time for the 2020 growing season. Cultivators are to operate under the 2014 Farm Bill for the 2019 planting season.

So Hemp Is Now Totally Legal, Right?

- Yes, but . . .
 - **Hemp** with THC levels of 0.3% or less = legal
 - The problem, however, is proving THC levels at state lines and at the time of import.
 - Where the distinction between hemp and marijuana is not obvious and reliant on test results, there is still some risk of seizure.
 - In practice, CBP may seize hemp on suspicion of it being marijuana.
 - **CBD** is another story...

What Is CBD?

- CBD is a non-psychoactive compound derived from the marijuana plant.
 - You don't get "high" from it.
- Proponents claim it helps with a myriad of health conditions, including anxiety, depression, chronic pain, skin conditions, and blood pressure, among others.
- Often used by ingesting orally or as topical skin treatment

FDA Stance on CBD

- Although CBD that contains less than 0.3 percent THC on a dry weight basis is now legal under the CSA and the Farm Act, the FDA still has federal regulatory oversight.
- **AND the FDA has said . . .**

FDA Stance on Therapeutic Claims

1. “Cannabis and **cannabis-derived products** claiming in their marketing and promotional materials that they’re **intended for use in the diagnosis, cure, mitigation, treatment, or prevention of diseases** (such as cancer, Alzheimer’s disease, psychiatric disorders, and diabetes) **are considered new drugs** or new animal drugs **and must go through the FDA drug approval process for human or animal use** before they are marketed in the U.S.”
2. **“Selling unapproved products with unsubstantiated therapeutic claims is not only a violation of the law, but also can put patients at risk,** as these products have not been proven to be safe or effective. This deceptive marketing of unproven treatments raises significant public health concerns, as it may keep some patients from accessing appropriate, recognized therapies to treat serious and even fatal diseases.”

FDA Stance on CBD as Food Additive

- “Additionally, it’s **unlawful** under the FD&C Act to introduce **food containing added CBD** or THC into interstate commerce, or to market CBD or THC products as, or in, dietary supplements, regardless of whether the substances are hemp-derived. This is because both CBD and THC are active ingredients in FDA-approved drugs and were the subject of substantial clinical investigations before they were marketed as foods or dietary supplements. **Under the FD&C Act, it’s illegal to introduce drug ingredients like these into the food supply, or to market them as dietary supplements.** This is a requirement that we apply across the board to food products that contain substances that are active ingredients in any drug.”

More FDA Guidance Is Coming . . .

- **What's Next?**

- The FDA will hold a **public hearing** on **May 31, 2019**, and provide an opportunity for written public comment. The FDA is looking for stakeholders to share their experiences and challenges with these products, including information and views related to product safety.
- The FDA is forming an **internal agency working group** to explore potential pathways for dietary supplements and/or conventional foods containing CBD to be lawfully marketed; including a **consideration of what statutory or regulatory changes** might be needed and what the impact of such marketing would be on the public health.
- The FDA has updated its **website FAQs** on CBD to help members of the public understand how the FDA's requirements apply to these products.

Recent FDA Enforcement Actions

- **The FDA Enforcement Risk Is Real**
- Over the past several months, the FDA has issued multiple warning letters to companies marketing CBD products with what it calls “egregious and unfounded claims that are aimed at vulnerable populations.”

Impermissible Therapeutic Claims

- **Examples of claims that the FDA has deemed illegal**
 - “CBD successfully stopped cancer cells in multiple different cervical cancer varieties.”
 - “CBD also decreased human glioma cell growth and invasion, thus suggesting a possible role of CBD as an antitumor agent.”
 - “For Alzheimer’s patients, CBD is one treatment option that is slowing the progression of that disease.”
 - “Fibromyalgia is conceived as a central sensitization state with secondary hyperalgesia. CBD has demonstrated the ability to block spinal, peripheral, and gastrointestinal mechanisms responsible for the pain associated with migraines, fibromyalgia, IBS, and other related disorders.”
 - “Cannabidiol may be effective for treating substance use disorders.”
 - “CBD reduced the rewarding effects of morphine and reduced drug seeking of heroin.”
 - “CBD may be used to avoid or reduce withdrawal symptoms.”

SBA Loans: Lending to MRBs?

- No SBA financial assistance for businesses engaged in any activity that is illegal under federal, state, or local law
- Applies to both 7(a) and 504 loans

SBA Guidance on Marijuana-Related Businesses

- Per SBA's 2019 SOPs
 - **Both direct and indirect marijuana businesses are ineligible**
 - **Direct** = Grows, produces, processes, distributes, or sells marijuana or marijuana products, even if state-legal and regardless of the amount of such activity
 - **Indirect** = Derives any part of gross revenue for the previous year (or, if start up, projects to derive any gross revenue for the next year) from sales to direct marijuana businesses of products or services that could reasonably be determined to support the “use, growth, enhancement, or other development” of marijuana. Examples: provide testing services, or sell grow lights or hydroponic equipment to a direct business

SBA Guidance on Marijuana-Related Businesses

- In addition, during life of SBA-guaranteed loan, borrower may not lease space to a business engaged in any illegal activity, including to any direct or indirect marijuana business.
- **Reasoning:** Collateral could be subject to seizure and because payments on SBA loan would be derived from illegal activity.
- If borrower leases to an ineligible MRB, SBA District Counsel must be consulted.

Secure and Fair Enforcement Banking Act of 2019 (SAFE Banking Act)

- Backed by the ABA on March 7, 2019
 - **The Issue**
 - 33 states / 68% of U.S. population have access to state legal cannabis
 - **The FI Problem**
 - Public safety and tax compliance; all-cash business
 - All proceeds of MRB are unlawful proceeds under federal law even if operating in full compliance with state law
 - FIs risk sanctions, loss of access to payment systems, loss of charter
 - No safe harbor protecting FIs from criminal or civil liability for money laundering

The SAFE Banking Act of 2019

- Doesn't remove cannabis from Schedule I of the Controlled Substances Act
- Would allow state-compliant MRBs to access banking services and products, including checking accounts, credit cards, loans, etc.
- Would bar federal regulators from canceling deposit insurance or otherwise sanctioning FIs if they provide services to state-compliant MRBs

The SAFE Banking Act of 2019

- Would also protect ancillary businesses that work with MRBs from being charged with money laundering and other financial crimes
- Requires FinCEN to develop further guidance to help FIs understand how to legally serve MRBs
- Federal banking regulators must adopt consistent guidance and examination procedures for FIs providing services to MRBs

SAFE Banking Act: Bipartisan and Regulator Support

- House version currently has 165 cosponsors. Companion legislation has been introduced in the Senate.
- Treasury Secretary Steve Mnuchin's take on banking solutions:
 - "There is not a Treasury solution to this . . . There is not a regulator solution to this. If this is something that Congress wants to look at on a bipartisan basis, I'd encourage you to do this. This is something where there is a conflict between federal and state law that we and the regulators have no way of dealing with."

The SAFE Banking Act of 2019: The ABA Position

The bipartisan SAFE Banking Act would be an important step toward enabling financial services for cannabis-related businesses. The bill specifies that proceeds from a legitimate cannabis business would not be considered unlawful under federal money laundering statutes or any other federal law, which is necessary to allow financial services to cannabis businesses as well as any ancillary businesses that derive some portion of their income from cannabis businesses. The bill would also direct FinCEN, and the federal banking regulators through the Federal Financial Institutions Examination Council, to issue guidance and exam procedures for banks doing business with cannabis related legitimate businesses. Explicit, consistent direction from federal financial regulators will provide needed clarity for banks and help them to better evaluate the risks and supervisory expectations for cannabis-related customers. The SAFE Banking Act is not a cure for all cannabis banking challenges, but it is an important measure that helps clarify many issues for the banking industry and regulators.

Other Calls to Remove Legal Hurdles to Banking MRBs

- Strengthening the Tenth Amendment Through Entrusting States (STATES) Act
 - Would amend the CSA, making provisions inapplicable to state-compliant MRBs
- April 15, 2019: Maine Bureau of Financial Institutions and other state banking supervisors sent letter to Congress, urging passage of legislation creating safe harbor for FIs to serve state-compliant MRBs

- **Would have allowed Maine-chartered credit unions to obtain private deposit insurance to provide financial services to Maine dispensaries and caregivers**
 - Died in Committee on April 24, 2019
- **Opposition**
 - Maine Bureau of Financial Institutions
 - Maine Bankers Association
 - Rep. Seth Barry (Sponsor) ultimately pulled support

- **Reasoning**

- Fix is regulatory relief at federal level
- Private insurance is not a solution
- Still need a Federal Reserve Master Account to have access to payment systems and electronic transactions, wires, and check clearing
- There's only one private credit union insurer. No one knows if they are willing to entertain a privately insured MRB credit union.
- Without NCUA insurance = no federal regulator; puts entire burden on State of Maine for regulatory oversight

What Does All This Mean for FIs?

- **Banking certainty won't come until a federal fix is adopted.**
- In the meantime, FIs must weigh the risks:
 - Do you know your customer?
 - Do you have robust customer due diligence review processes and MRB-SAR policies in place? Have they been vetted by legal counsel and regulators?
 - Reading the tea leaves . . . What's the risk of a federal enforcement action?
 - If you decide to wait for the federal fix, will you be ready when it comes?

Final Thought

- Senator Cory Gardner, a Republican from Colorado:

“People of good faith—both in the industry and outside of it—are at risk of being a federal felon despite complying with state law. And the cash on the streets is a big public safety and law enforcement concern . . .”

Questions



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