

Emerging Issue

Regulatory Challenges to Cannabis Financing

Despite increased legalization at the state level of medical and adult-use recreational marijuana, illegality of non-hemp, cannabis at the federal level as a Schedule 1 controlled substance under the Controlled Substances Act (CSA) is an impediment for businesses in the cannabis industry (MRBs) to get access to banking and financing. Federal agencies have provided guidance, but processes are complex and entail a great deal of risk for a financial institution.

Below are some of the key aspects of federal guidance and a look toward proposed legislation to alleviate the state and federal legal tensions.

Existing Legislation and Regulatory Schemes

The Bank Secrecy Act (BSA), which was instituted to prevent money laundering and financial crimes, is the primary challenge for financial institutions to contend with when attempting to do business with MRBs.

Because all proceeds related to marijuana are considered unlawful under federal law, the effect is financial institutions subject to the BSA must monitor, scrutinize and report on funds derived from these activities as if they are unlawful.

With increasing state legalization, the Treasury Department's Financial Crimes Enforcement Network (FinCEN), which enforces the BSA, with the Department of Justice (DOJ), has provided regulatory guidance to financial institutions.

For More Information

Please contact the attorneys listed below or the Davis+Gilbert attorney with whom you have regular contact.



Joseph Cioffi
Partner/Chair
212 468 4875
jcioffi@dglaw.com



Nicole Serratore
Staff Attorney
646 673 8349
nserratore@dglaw.com

DAVIS +
GILBERT

Existing Legislation and Regulatory Schemes (cont'd)

DOJ Guidance

In 2013 and 2014, memos from then Deputy Attorney General James M. Cole (Cole Memo) set the tone for DOJ enforcement of marijuana policy, stating that the DOJ would focus their limited resources on “the most significant threats” and gave a list of eight priority factors for enforcement.

The DOJ’s enumerated eight priorities for enforcement included things like “preventing the distribution of marijuana to minors,” “preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels,” and “preventing the diversion of marijuana from states where it is legal under state law in some form to other states.”

While creating a kind of safe harbor to allow business to proceed with state-authorized MRBs if their activities fell outside those priorities (yet, still emphasizing the BSA applied to all transactions), this was only temporary and discretionary guidance which was rescinded in 2018. Even with rescission, the DOJ’s eight priorities underpin current FinCEN guidance.

FinCEN Guidance on Due Diligence

As part of regular BSA obligations, financial institutions must conduct customer due diligence. But when working with MRBs, they need to take into consideration whether these businesses could trigger a Cole Memo priority.

A due diligence review of an MRB should determine whether the MRB is operating legally within that state. They must understand what normal activity would be for that kind of business, continually monitor public sources about that business and related parties, and watch for suspicious activity and red-flags.

FinCEN Guidance on Suspicious Activity Reporting

The BSA requires financial institutions to file with FinCEN suspicious activity reports (SARs) when providing financial services to MRBs. Different levels of SARs will be required depending on the financial institution’s assessment of whether the Cole Memo priorities are triggered.

All of this puts a great deal of responsibility on the financial institution with high risks if they end up working with a non-compliant business. With the SARs, they are providing FinCEN with evidence of their interactions with companies who could be viewed as engaging in unlawful activities (even if legal at the state level). There is no guarantee the DOJ would not pursue a financial institution, though in practice, we have not seen increased enforcement since the rescission of the Cole memo.

Proposed Federal Legislation

Secure and Fair Enforcement (SAFE) Banking Act

This bill is narrowly tailored to provide a safe harbor for financial institutions and would allow depository institutions to provide banking services to a legitimate cannabis-related business without regulatory penalty. Proceeds from activities of legitimate cannabis-related businesses would not be considered the result of unlawful activity and not subject to anti-money laundering laws. The bill passed the House in April 2021 and was introduced in the Senate, but leading Senate Democrats favor a broader approach of decriminalization.

Marijuana Opportunity, Reinvestment and Expungement (MORE) Act

This House bill was previously passed by the House in 2020 and was reintroduced in the House in May 2021. If passed, it would:

- Remove marijuana from the CSA list and decriminalize it at the federal level both retroactively and going forward.
- Establish a process to expunge non-violent federal cannabis convictions and conduct sentencing review hearings related to federal cannabis offenses.
- Create a grant program to provide services to those impacted by the war on drugs.
- Allow the Small Business Association to make loans to legitimate cannabis-related businesses.

Cannabis Administration and Opportunity Act

This is a draft bill from Senate Democrats which has yet to be introduced, but it approaches cannabis reform from a restorative justice perspective and is similar to the MORE Act.

It would:

- Remove marijuana from the CSA.
- Shift regulation of cannabis from the Drug Enforcement Agency to the FDA, TTB, and the ATF.
- Recognize state law as controlling over the possession, production or distribution of cannabis but still provide for criminal penalties for illegal cannabis diversion.

Possessing, using, distributing, and/or selling marijuana or marijuana-based products is illegal under federal law, regardless of any state law that may legalize or decriminalize such activity under certain circumstances. Although federal enforcement policy may at times defer to states' laws and not enforce conflicting federal laws, interested businesses and individuals should be aware that compliance with state law in no way assures compliance with federal law, and there is a risk that conflicting federal laws may be enforced in the future. No legal advice we give is intended to provide any guidance or assistance in violating federal law.