



# Banking and Cannabis

William S. Hackney III

Christopher K. Loftus

USLAW Presentation

October 30, 2019

# Cannabis v. Marijuana v. Hemp

- Cannabis Sativa L plant includes both marijuana and hemp varieties
- Same genus – cannabis/Same species – sativa
- THC content is in practice (and law now) the differentiator
- THC concentration  $\leq 0.3\%$  = hemp
- THC concentration  $> 0.3\%$  = cannabis/marijuana
- Use of the term “marijuana”

# CBD

- Cannabidiol
- Cannabinoids (of which cannabidiol is one of many) are found in the cannabis plant
- Hemp-derived CBD v. Cannabis-derived CBD

# The Controlled Substances Act

- 21 U.S.C. §101, *et seq.*
- “Marihuana” broadly defined in the CSA as “all parts of the plant *Cannabis sativa* L...”
- Does NOT include “hemp” as defined in the 2018 Farm Bill
  - “the plant *cannabis sativa* L. and any part of the plant with a [THC] concentration of not more than 0.3 percent by dry weight”

# Regulatory Framework

- Penalties for violation of the CSA include:
  - Seizure and forfeiture of violator's assets
- Aiding and abetting statute
  - Potential liability as a principal actor
- BSA violations
- AML violations

# DOJ Guidance to Federal Prosecutors

- Beginning under Obama Administration
- Deputy Attorney General David W. Ogden issues first memo in 2009
- Offered guidance to federal prosecutors on the enforcement of the CSA in face of increasing number of states legalizing cannabis
- Reiterated intent to enforce the CSA
- But recommends a “rational use” approach

# DOJ Guidance to Federal Prosecutors

- Deputy Attorney General James M. Cole issues follow up memos in 2014
- The so-called “Cole Memo” or “Cole Memos”
- Feb. 14, 2014 Memo specifically addresses “Marijuana Related Financial Crimes”
- The Cole Memo Enforcement Priorities

# Cole Memo Enforcement Priorities

- Preventing the distribution of marijuana to minors
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels
- Preventing the diversion of marijuana from states in which it is legal under state law to other states



# Cole Memo Enforcement Priorities

- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use

# **Cole Memo Enforcement Priorities**

- Preventing the growing of marijuana on public lands
- Preventing marijuana possession or use on federal property

# FinCEN Guidance

- Financial Crimes Enforcement Network or “FinCEN”
- Also issued a memo on Feb. 14, 2014
- To “clarify Bank Secrecy Act (‘BSA’) expectations for financial institutions seeking to provide services to marijuana-related businesses”

# FinCEN Guidance

- Customer due diligence should include:
  - Verifying with the appropriate state authorities whether the business is duly licensed and registered
  - Reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business
  - Requesting from state licensing and enforcement authorities available information about the business and related parties

# FinCEN Guidance

- Developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the types of customers to be served (e.g., medical versus recreational customers)
- Ongoing monitoring of publically available sources for adverse information about the business and related parties
- Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk

# FinCEN Guidance

- Customer due diligence also includes
  - Considering whether a marijuana-related business implicates one of the Cole Memo Priorities or violates state law
  - If so, this information needs to be reported as part of routine BSA obligations
- Suspicious Activity Reports

# Suspicious Activity Reports

- Obligation to file an SAR unaffected by state law legalizing marijuana-related activity
- Financial institutions required to file an SAR if financial institution knows, suspects, or has reason to suspect a transaction:
  - Involves funds derived from illegal activity or is an attempt to disguise funds derived from an illegal activity
  - Is designed to evade regulations promulgated under the BSA

# Suspicious Activity Reports

- Lacks a business or apparent lawful purpose

Because the CSA prohibits the distribution or sale of marijuana, financial transaction involving a cannabis-related businesses would generally involve “funds derived from illegal activity”



# Suspicious Activity Reports

- “Marijuana Limited” SAR
  - To be filed when customer due diligence does NOT implicate any of the Cole Memo Enforcement Priorities or violate state law
  - Content includes:
    - Identifying information of the subject and related parties
    - Addresses of the subject and related parties
    - The fact that the filing institution is filing the SAR solely because the subject business is a CRB
    - No additional suspicious activity to report

# Suspicious Activity Reports

- To be updated in accordance with existing FinCEN guidance on the timing of filing continuing activity reports
- Continuing activity report may contain same information as originally reported plus update of actual financial activity since last filing
- However...

# Suspicious Activity Reports

- “Marijuana Priority” SAR
  - To be filed when customer due diligence implicates one of the Cole Memo Enforcement Priorities
  - Content includes:
    - Identifying information of the subject and related parties
    - Addresses of the subject and related parties
    - Details regarding the enforcement priorities the financial institution believes have been implicated
    - Dates, amounts, and other relevant details of the financial transactions involved in the suspicious activity

# Suspicious Activity Reports

- “Marijuana Termination” SAR
  - To be filed if a financial institution deems it necessary to terminate a relationship with a CRB in order to maintain effective anti-money laundering compliance program

# Potential Red Flags

- Financial Institutions should watch for:
  - A CRB appears to be using a state-licensed cannabis-related business as a front to launder money derived from other criminal activity
  - A CRB is unable to produce appropriate documentation to support its licensure and that it is operating consistent with state law
  - A CRB is unable to demonstrate the legitimate source of outside investments

# Potential Red Flags

- A CRB is seeking to conceal or disguise its involvement in cannabis
- Customer due diligence reveals negative information
- The CRB, its owners, managers, etc. are or have been the subject of an enforcement action by state or local officials responsible for monitoring CRB's
- A CRB engages in international or interstate activity
- Owners or managers of CRB live outside the state

# Potential Red Flags

- A CRB is located on federal property or that the product was grown on federal lands
- A CRB is located too close to a school or other restricted area and thus not in compliance with state law
- A CRB which purports to be “non-profit” appears to conduct activity inconsistent with that designation

# Currency Transaction Reports

- Financial institutions must report currency transactions in relation to cannabis-related businesses
- A CRB may not be treated as a non-listed business and is not eligible for an exemption to CTR obligations



# Proposed Legislation

- The SAFE Banking Act
- The STATES Act
- Various state-level proposals

# The **SAFE** Banking Act

- The Secure and Fair Enforcement Banking Act
- Provides safe harbors for financial institutions providing financial services to cannabis-related businesses
- Provides that proceeds of a transaction with a CRB are not proceeds of an unlawful activity
- Requires compliance with FinCEN guidance

# The STATES Act

- The Strengthening the Tenth Amendment Through Entrusting States Act
- Provides that the CSA would generally not apply to cannabis-related conduct that is legal under state law
- Again would provide that proceeds of a transaction with a CRB are not proceeds of an unlawful activity
- Cannabis-related conduct legal under state law could not serve as the basis for forfeiture

# State-Level Proposals

- Oregon and California have proposed state-level legislation to create state-owned banks specifically designed to serve only the cannabis industry
- Would be wholly separate and independent from the federal banking system

# The Bankruptcy Problem

- Chapter 7 unavailable
  - Requesting federal relief while acknowledging violations of federal law
  - Cannot require chapter 7 trustees to take possession of and sell cannabis-related assets
- Chapter 11 unavailable
  - Plans not proposed in good faith
  - Plan proposed by a means otherwise prohibited by law

# The Bankruptcy Problem

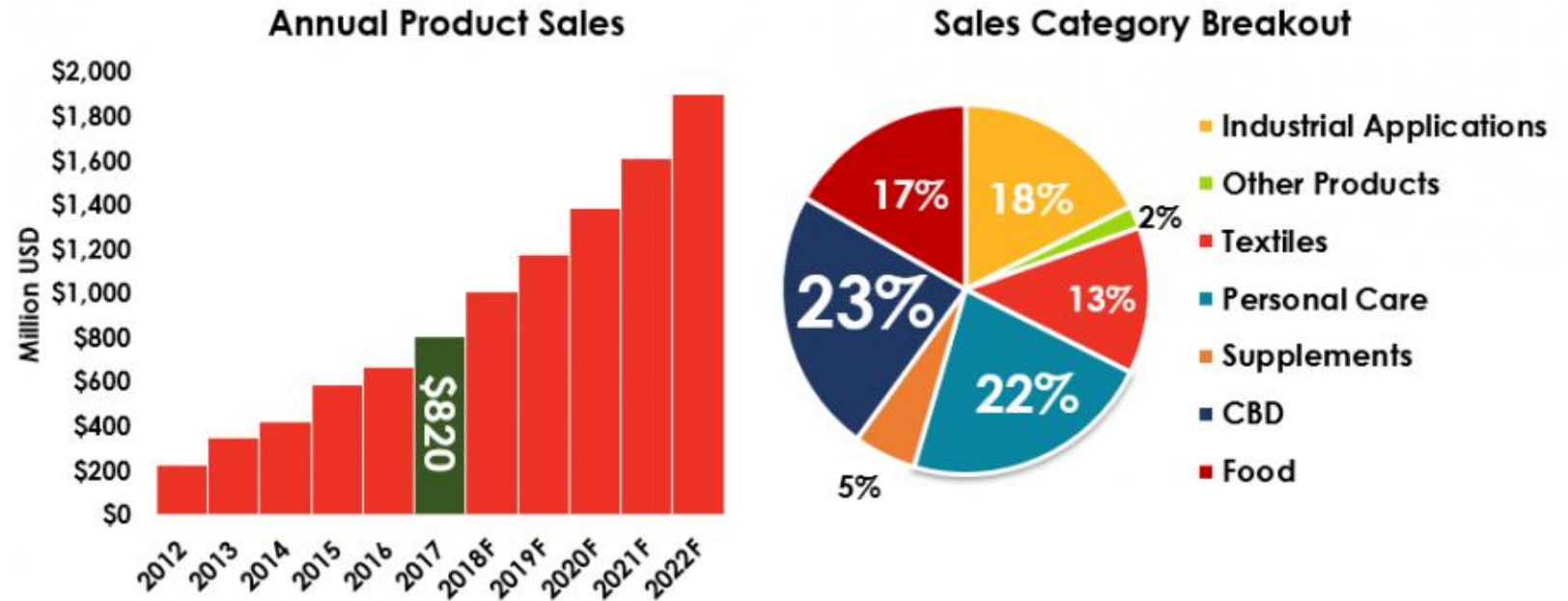
- Chapter 13
  - Ongoing cannabis-related activities are ongoing violations of federal law
  - Chapter 13 trustee violating federal law by disbursing funds derived from the debtor's cannabis-related activities
- So it's a race to the courthouse for creditors of cannabis-related businesses

# Hemp



# The Hemp Industry

Figure 3. Hemp Product Sales





# Current Regulatory Framework

- 2018 US Farm Bill
- USDA Regulations are Imminent
- State Regulations to Follow

# Lending Risks with Hemp

- Bank needs to monitor crop
- Know your customer
- Regulations will be changing
- Develop a robust compliance program
- Review loan documents
- Will the hemp industry be profitable?

**William S. Hackney III**

Partner, Chicago, Illinois

**Practice Areas**

Insolvency & Restructuring  
Cannabis  
Creditors' Rights  
Consumer Financial Services Defense

**Memberships**

American Bankruptcy Institute  
Commercial Finance Association  
National Creditors Bar Association  
Turnaround Management Association

**Education**

University of Illinois B.A. (Finance), 1994  
St. John's University School of Law, J.D., 1997

**Professional Background**

Bill is a member of SmithAmundsen LLC's Financial Services Group, concentrating his practice in the area of insolvency, restructuring, and creditors' rights. Bill has significant experience representing debtors, lenders, secured creditors, creditors' committees, trustees, and other parties in chapter 11 and chapter 7 cases as well as out-of-court workouts and restructurings and the related litigation that accompanies the same. Bill advises financial institutions and cannabis-related businesses on the interaction between state cannabis laws and federal banking and bankruptcy laws. He also acts as outside bankruptcy counsel to a number of business entities and provides general business counseling in distressed situations. Bill also represents a number of his clients in their FDCPA, FCRA and similar consumer finance defense claims.

Bill is a member of the bar in Illinois and New York. He is admitted to practice before the state courts in those jurisdictions as well as numerous federal courts across the country including the United States District Court for the Northern District of Illinois and the Southern District of New York, among others. He is also a member of the Trial Bar in the Northern District of Illinois. In 2011 and 2012, Bill was named to the *Illinois Super Lawyers Rising Stars\** list and from 2017 to the present Bill was named to the *Illinois Super Lawyers* list, peer review designations published by Thompson Reuters™.

**Sample of Recent Presentations**

DRI Cannabis Law Seminar – Are Bankruptcy Courthouse Doors Closed to Marijuana-Related Businesses?  
– May 15, 2019, Washington, D.C.  
National Creditors Bar Association – The 25 Bankruptcy Words You Should Know but Probably Don't  
– May 18, 2018, Austin, Texas  
The Honorable Robert E. Ginsburg Annual Program on Commercial Bankruptcy Law – WARN and Chapter 11  
– November 14, 2017, Chicago, Illinois

**SmithAmundsen LLC**  
150 North Michigan Avenue  
Chicago, Illinois 60601  
312.894.3370  
whackney@salawus.com

**Christopher K. Loftus**

Member, Cedar Rapids, Iowa

**Practice Areas**

Banking and Finance  
Banking Litigation  
Bankruptcy and Creditors' Rights  
Business and Commercial Litigation

**Memberships**

Iowa State Bar Association  
Johnson County Bar Association  
Corridor Credit Association

**Education**

University of Iowa B.A. (Political Science & Journalism), 2002  
University of Iowa College of Law, J.D., 2006

**Professional Background**

Chris represents lenders and other commercial creditors in a variety of business and litigation matters. He is experienced in foreclosures, including residential, commercial and agricultural real estate, receiverships, equipment financing, pursuing loan collateral and negotiating workouts. Chris also advises lenders on issues involving regulatory compliance, consumer and commercial transactions, including secured and unsecured lending, asset-based and real estate lending, loan documentation and mortgage enforceability.

Chris is an experienced litigator, having represented lenders in proceedings in courtrooms throughout Iowa and other jurisdictions. He has successfully represented creditors in matters before the state and federal courts, bankruptcy courts, and appellate courts.

Chris is a member of the bar in Iowa and Minnesota. He is admitted to practice before the state courts in those jurisdictions as well as numerous federal courts across the country including the United States District Courts for the Northern and Southern District of Iowa and the District of Minnesota among others. In 2019 Chris was named to the Corridor Business Journal's Forty Under 40 list and in 2015-2016, Chris was named to the *Great Plains Super Lawyers Rising Star* list.

**Sample of Recent Presentations**

New Age Borrowers: Considerations Regarding Marijuana and Marijuana Related Businesses  
– July 11, 2019, Webinar  
Minimizing Risks of Problematic Ag Loans  
– September 13, 2018, Webinar  
Regulatory Update: A Review of the Recent Changes to the Military Lending Act  
– December 07, 2016, Webinar

**Simmons Perrine Moyer Bergman PLC**  
115 3<sup>rd</sup> Street SE, Suite 1200  
Cedar Rapids, IA 52401  
319.366.7641  
cloftus@spmbllaw.com