

# Banking and Finance for the Marijuana Industry

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This article discusses the applicable federal statutes regarding the regulation of the marijuana industry. It also discusses the financing of this market, the latest Financial Crimes Enforcement Network (FinCEN) and Justice Department Guidance, recommendations relating to lender due diligence with marijuana-based businesses, bank forensic audits of marijuana businesses and determining the source of funds, and suggestions for maximizing the chances of obtaining a loan.

The medical and adult use marijuana business in the United States is already a multibillion dollar industry. As of January 1, 2020, marijuana is legal in 11 states and Washington, D.C. for use by adults over the age of 21 and legal for medical use in 33 states and Washington, D.C. Marijuana Business Daily projects sales of marijuana for 2020 to be between \$15.7 and \$19 billion. By 2023, Marijuana Business Daily projects sales to be between \$25 billion and \$30.4 billion. See [Exclusive: US retail marijuana sales on pace to rise 35% in 2019 and near \\$30 billion by 2023](#). To date, due to the fact that marijuana growing, processing, distribution, and consumption is illegal federally, this huge and rapidly expanding industry does not have any appreciable access to banking services and institutional funding. This has and will continue to cause significant problems for the industry as well as for states (where marijuana use is legal) in their efforts to regulate and/or tax the industry.

## Federal Statutes Affecting Financing

The current list of federal statutes affecting bank and private financing is a veritable house of horrors for lenders and borrowers alike.

### The Controlled Substances Act, 21 U.S.C. § 801 et seq. (the CSA)

Marijuana is listed as a Schedule I controlled substance under the CSA. 21 U.S.C. § 812. A Schedule I controlled substance under the CSA is a drug that has (1) a high potential for abuse, (2) no currently accepted medical use in treatment in the United States, and (3) a lack of accepted safety for use under medical supervision. Examples of other Schedule I controlled substances are heroin, LSD, ecstasy, mescaline, peyote, and psilocybin. All tetrahydrocannabinols (THC) are included in Schedule I except for THC in hemp. Cocaine and fentanyl are among those listed as Schedule II controlled substances; anabolic steroids are among those listed in Schedule III; and Ambien, Xanax, and Valium are among those listed in Schedule IV. It is a violation of the CSA for the unauthorized manufacture, distribution, or dispensing of a controlled substance. 21 U.S.C. § 841(a)(1). It is also a violation of the CSA to conspire to commit any violation of the CSA. 21 U.S.C. § 846. Moreover, “[w]hoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.” 18 U.S.C. § 2 (emphasis added). Thus, notwithstanding the existence of state laws that provide for legal use of marijuana, the CSA prohibits everyone, including banks and other lenders, from involving themselves with marijuana or the proceeds derived from their production, manufacture, or distribution. Banks and any financial institutions that have some connection to the payment system (checks, ATMs, credit/debit cards, internet banking, wire transfers, etc.) are subject to federal laws and regulations regardless of whether they are privately or publicly owned.

## **The Bank Secrecy Act, 12 U.S.C. § 1951 et seq., 31 U.S.C. § 5311 et seq. (the BSA)**

The Bank Secrecy Act of 1970 and related regulations (12 C.F.R. § 21.11), which seek to prevent money laundering and other financial crimes, place burdensome obligations on banks. Under the BSA, national banks as well as any federal branches and agencies of foreign banks licensed or chartered by the U.S. Office of the Comptroller of the Currency (OCC) are required to file a Suspicious Activity Report (SAR) with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) and state and local law enforcement agencies where appropriate when they detect a known or suspected violation of federal law or a suspicious transaction related to a money laundering activity or a violation of the BSA. These reports are required to be filed no later than 30 calendar days after the date of the initial detection of facts that may constitute a basis for filing a SAR. In situations involving violations requiring immediate attention, such as when a reportable violation is ongoing, the financial institution must immediately notify, by telephone, an appropriate law enforcement authority and the OCC in addition to filing a timely SAR.

Banks must maintain a copy of any SAR filed together with original or business record equivalent of any supporting documentation for five years from the date of the filing of the SAR. Whenever a national bank files a SAR, its management must promptly notify its board of directors or a committee of directors or executive officers designated by the board of directors to receive notice.

Failure to file a SAR in accordance with the BSA may subject the national bank, its directors, officers, employees, agents, or other institution-affiliated parties to supervisory action. Thus, even if a bank were willing to risk prosecution under the CSA and do business with marijuana businesses, it would also have to comply with the BSA and file SARs for virtually every transaction with such businesses.

For more information on the Bank Secrecy Act in general, see [Bank Reporting Requirements under the Bank Secrecy Act and OFAC Sanctions Laws](#).

## **The Federal Anti-money Laundering Statute, 18 U.S.C. § 1956 (AML)**

Banks interested in doing business with businesses in the marijuana industry will also have to contend with the federal anti-money laundering statute. Pursuant to the AML, any financial institution, as defined in 31 U.S.C. § 5312(a) (2) and any foreign bank who conducts or attempts to conduct a financial transaction, knowing that the property involved represents the proceeds of some form of unlawful

activity with the intent to promote the carrying on of specified unlawful activity or knowing that the transaction is designed in whole or in part to conceal or disguise the nature, location, source, ownership, or the control of the proceeds of specified unlawful activity or to avoid a transaction reporting requirement under state or federal law shall be sentenced to a fine of not more than \$500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than 20 years, or both.

The AML also prohibits cross-border transportation, transmission, or transfer of monetary instruments or funds intended to promote the carrying on of activity (such as conducting a marijuana-based business) that violates federal law.

For more information on federal anti-money laundering statutes and regulations, see [Bank Secrecy Act, USA PATRIOT Act, OFAC, and Other Anti-Money Laundering / Anti-Terrorism Regulations](#).

## **Justice Department and FinCEN Guidance**

In contrast to the statutes discussed above, the executive branch of the federal government has begun to address the fact that having a multibillion dollar industry, that is legal to some extent under the laws of over half of the states, without banking is not tenable. On August 29, 2013, the U.S. Department of Justice (DOJ) issued a memorandum, authored by Deputy Attorney General James M. Cole, to all U.S. Attorneys (the Cole Memo). By the Cole Memo, the DOJ adopted and published formal guidance restricting federal enforcement of the federal marijuana prohibition when individuals and entities act in accordance with state regulation of medical marijuana. In doing so, it listed a number of priorities including the prevention of:

- The distribution of marijuana to minors
- Cannabis revenues going to criminal enterprises, gangs, and cartels
- Diversion of marijuana from states where it is legal to other states
- State-authorized activity used as a cover for illegal activity, including trafficking of other illegal drugs
- Violence and the use of firearms in the cultivation and distribution of marijuana
- Drugged driving and exacerbation of other adverse public health consequences associated with marijuana use

- The growing of marijuana on public lands –and–
- Marijuana possession or use on federal property

In February 2014, the DOJ issued a second marijuana enforcement memorandum, which extended the Cole Memo's treatment of marijuana businesses to financial institutions that provide banking to marijuana businesses. The February 2014 DOJ Memo communicated that a financial institution's potential violations of BSA or AML would be treated as low law enforcement priorities so long as the financial institutions were working within the confines of robust state regulation and were continuing to follow adequate, risk-based anti-money laundering procedures.

At the same time, FinCEN addressed the issue of cannabis business banking accounts. These guidelines set forth that banks can provide financial services to marijuana businesses without violating existing federal regulations if they do the following:

- Ensure the business is duly licensed and registered with its state regulators.
- Vet and review all license applications and related financial and background documentation the cannabis business used to secure its license to operate from the state.
- Request and receive from state regulators and law enforcement all available information about the cannabis business and its related owners and financiers.
- Develop an understanding of the normal and expected commercial activity for the business, including the products to be sold and customer profiles. –and–
- Monitor publicly available sources, including social media accounts, to ensure the marijuana business complies with applicable state laws and the 2013 Cole Memo.

Banks also must file SARs at least quarterly with FinCEN for all their marijuana business clients. There are no direct or immediate consequences arising from these SAR filings, but these SARs enable the federal government to know exactly who owns and runs the marijuana businesses and with whom they are banking.

The FinCEN guidelines increase banking costs for banks with marijuana business accounts, nearly all of which costs are passed on to their marijuana clients. Accordingly, most marijuana businesses must pay a financial premium just to have a bank account. There remains a significant lack of banking for marijuana businesses, and major banking institutions are likely not to take on marijuana business accounts unless and until the federal prohibition

against marijuana ends. In the meantime, many marijuana businesses will no doubt continue operating on an all-cash basis, which renders them easy targets for criminal activity and complicates their business operations.

If a bank or credit union sees too many red flags with a marijuana business, that business will not secure a bank account. Some of these red flags under the FinCEN guidelines include:

- Anonymous out-of-state or international investors or financiers
- An inability to trace money flow to investors, owners, and/or vendors
- Failure to secure a state and/or local license to operate
- Owners and/or financiers who have significant criminal histories
- The business's failure to report income and/or pay taxes to the state or the federal government
- The business's violation of state operational laws and rules –and–
- The failure to timely renew state and/or local operational licenses

The Cole Memo was rescinded by former Attorney General Jeff Sessions on January 4, 2018. In rescinding the Cole Memo, Mr. Sessions "returned" full discretion to individual prosecutors. Mr. Sessions resigned as U.S. Attorney General on November 7, 2018, and his successor, William Barr, stated during his confirmation hearing that he would not target state legal marijuana businesses. Attorney General Barr further stated that it was up to Congress to act.

In December of 2014, the Rohrabacher-Farr amendment (now known as the Rohrabacher-Blumenauer amendment, hereafter the Rohrabacher Amendment) was enacted by Congress. It prohibits the DOJ from using any of the funds appropriated by Congress to prevent states with medical marijuana laws "from implementing their own State laws that authorize, the use, distribution, possession, or cultivation of medical marijuana." The Rohrabacher Amendment was the basis of a ruling by the Ninth Circuit Court of Appeals in *United States v. McIntosh*, 833 F.3d 1163 (9th Cir 2016), which prohibited the DOJ from continuing to prosecute several defendants who complied with their respective states' medical marijuana laws. The Rohrabacher Amendment has been renewed continuously since its enactment, most recently on December 20, 2019, through the signing of the fiscal year 2020 spending bill and is presently in effect until September 30, 2020.

On September 25, 2019, the SAFE Banking Act was passed in the U.S. House of Representatives. The SAFE Banking Act generally prohibits a federal banking regulator from penalizing a depository institution for providing banking services to a legitimate marijuana-related business. Specifically, the bill prohibits a federal banking regulator from:

- Terminating or limiting the deposit insurance or share insurance of a depository institution solely because the institution provides financial services to a legitimate marijuana-related business
- Prohibiting or otherwise discouraging a depository institution from offering financial services to such a business
- Recommending, incentivizing recommending, incentivizing, or encouraging a depository institution not to offer financial services to an account holder solely because the account holder is affiliated with such a business
- Taking any adverse or corrective supervisory action on a loan made to a person solely because the person either owns such a business or owns real estate or equipment leased or sold to such a business –or–
- Penalizing a depository institution for engaging in a financial service for such a business

Also, the proposed legislation provides that a depository institution or a Federal Reserve bank shall not, under federal law, be liable or subject to forfeiture for providing a loan or other financial services to a legitimate marijuana-related business.

The SAFE Banking Act is presently being discussed and considered in the Senate Banking Committee. The Chairman of that Committee, Senator Mike Crapo (R-ID), stated in December of 2019 that he had significant concerns with the legislation, specifically that it “does not address the high level potency of marijuana, marketing tactics to children, lack of research on marijuana’s effects, and the need to prevent bad actors and cartels from using the banks to disguise ill-gotten cash to launder money into the financial system.” Since then, a number of interested organizations on all sides have submitted information to the chairman relating to the legislation. The progress or lack thereof of this legislation bears watching in 2020. For more information on the SAFE Banking Act, see [The SAFE Banking Act to Increase Access Banking Legal Marijuana-Related Businesses](#).

## Lender Due Diligence with Marijuana Businesses

Lenders, consistent with their obligations under BSA/AML and FinCEN, are likely to perform enhanced due diligence on marijuana businesses seeking to borrow money. This would include requesting and verifying with the appropriate state authorities whether the business is appropriately licensed and registered, and background checks of account holders and related individuals associated with the business. Marijuana businesses should also be prepared to provide copies of all applicable state licenses, applications, business plans, financial plans, corporate bylaws, financial statements, and tax returns. Lenders may also seek to review the marijuana businesses’ promotional materials, including its website to determine its target customers and to gain an increased understanding of products and services offered.

Some banks are likely to require ongoing site inspections to review areas such as business locations, products and services offered, customer base, inventory, signage and license, and physical security. A marijuana business contemplating a relationship with a bank should also maintain written policies and procedures addressing:

- Employee screening
- Due diligence standards for new customers
- Procedures for properly reporting to the IRS receipts of large amounts of cash
- The purchase of marijuana if not grown by the business itself
- Compliance with all state and federal regulatory requirements

## Bank Forensic Audits of Marijuana Businesses – Determining the Source of Funds

As set forth above, banks are obligated to file a SAR in connection with any transaction where it knows, suspects, or has reason to suspect that a transaction conducted or attempted by, at, or through the financial institution (1) involves funds derived from illegal activity or is an attempt to disguise funds derived from illegal activity, (2) is designed

to evade regulations promulgated under the BSA, or (3) lacks a business or apparent lawful purpose. Because federal law prohibits the distribution and sale of marijuana, financial transactions involving a marijuana-related business would generally involve funds derived from illegal activity. Therefore, a financial institution is required to file a SAR on activity involving a marijuana-related business (including those duly licensed under state law), in accordance with this guidance and FinCEN's suspicious activity reporting requirements and related thresholds.

One of the BSA's purposes is to require financial institutions to file reports that are highly useful in criminal investigations and proceedings. FinCEN's 2014 guidance assists financial institutions in determining how to file a SAR that facilitates law enforcement's access to information pertinent to a priority. In furtherance of these requirements, banks may require forensic audits of the marijuana business to determine the source of all funds deposited by the marijuana business.

## Getting the Loan – Providing Transparency to Lenders

Given the onerous obligations banks face under the BSA and AML, marijuana businesses hoping to get loans from banks (perhaps after some form of the SAFE Banking Act passes through Congress) are going to have to be willing to show the banks everything about their business—complete transparency. Businesses in this area should also have a strong compliance program, and independent forensic audits will help build trust with prospective lenders.

For more information on the cannabis industry today, see [Cannabis Resource Kit](#).

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