Financial Services for Cannabis and Hemp Businesses

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Cannabis

With the passage of legislation by the Illinois General Assembly, Illinois became the 11th state (along with the District of Columbia) to allow the recreational use of marijuana. In addition, 33 states and the District of Columbia currently allow cannabis to be used for medical purposes.

Despite this state legislation, cannabis is still a Schedule 1 controlled substance under The Controlled Substances Act (the "CSA").

Because cannabis is still a controlled substance, businesses involved in the cannabis industry face difficulties in securing services from depository institutions, including opening deposit accounts, accepting credit cards and securing loans. Due to the lack of such access, many of these businesses have to operate on a cash basis, presenting security problems for the business and its customers.

Further, individuals who work for cannabis businesses may also experience difficulty in securing banking services.

Depository institutions also have to be concerned about dealing with businesses that provide indirect services to cannabis businesses. It may be difficult for depository institutions to vet vendors and suppliers (such as accountants, delivery services) that provide services to a cannabis business.

In addition, depository institutions providing services to cannabis businesses must comply with various regulations and FinCen's guidance on filing SARs. Compliance can be time consuming and costly. In addition, the FinCen guidance can be revoked or revised at any time.

In an attempt to address some of these issues, the Secure and Fair Enforcement Banking Act of 2019 (the "SAFE Banking Act" or the "Act") was introduced in the U.S. House (H.B. 1595). The SAFE Banking Act was sponsored by Rep. Ed Perlmutter, D-Colo; it has 206 cosponsors including 26 Republicans.

On September 25, 2019, the House approved the Act by a vote of 321-103. The legislation will now move to the Senate. It has the strong support of state attorneys general and organizations representing the financial services industry.

If enacted, the SAFE Banking Act would allow depository institutions (including de novo institutions) to provide financial services to cannabis-related legitimate businesses ("CRLBs") and businesses that provide services to CRLBs ("CRLB service providers").

The legislation also provides protections for insurance companies that provide insurance to CRLBs and CRLB service providers.

The Act, however, makes it clear that nothing in the legislation requires a depository institution or an insurer to provide financial services to a CRLB or a CRLB service provider.

"Financial services" would include services like checking accounts, payment cards, and electronic funds transfers and financial services as defined in Section 1002 of the Dodd-Frank Act. Such services also include: (i) the business of insurance; (ii) transferring of funds by any means, including credit or debit cards or other devices, including electronic funds transfers; (iii) acting as a money transfer business which makes use of a depository institution in connection with facilitating a payment for a CRLB or a CRLB service provider; and (iv) providing armored car services. This term does not include, among other things, underwriting or broker-dealer activities.

A CRLB, a "cannabis-related legitimate business," is defined as a manufacturer, producer or any person or company that, pursuant to a law established by a state or political subdivision, participates in any business or organized activity that involves handling cannabis or cannabis products, including cultivating, producing, manufacturing, selling, transporting, displaying, dispensing, distributing, or purchasing cannabis or cannabis products.

A CRLB service provider includes a business that sells goods or services to a CRLB or provides business services relating to cannabis. The latter services encompass the sale or lease of real estate or other property.

The SAFE Banking Act only offers protections to depository institutions that provide services to customers operating in states where such activity is legal; it does not decriminalize marijuana on the federal level.

Furthermore, under the legislation, depository institutions are still responsible for ensuring they only provide financial services to CRLBs who are operating in compliance with applicable state law, and that they carefully monitor and report, when needed, the activities of such customers. As is currently the case, depository institutions should still vet these customers by conducting a thorough risk-based analysis when deciding whether to offer services to CRLBs and CRLB service providers. They should carefully vet these customers as part of the process.

Depository institutions will also have to continue to comply with existing law and guidance regarding suspicious activity reporting such as the FinCen SARs rules. The Act directs the Secretary of the Treasury to ensure that such guidance is consistent with the intent of the SAFE Banking Act.

The Act also instructs the Federal Financial Institutions Examination Council ("FFIEC") to develop uniform guidance and examination procedures for banks that provide services to CRLBs and their service providers. The federal banking regulators would also be expected to issue their own guidance and examination procedures consistent with that of the FFIEC.

Section 2 of the SAFE Banking Act would prohibit federal banking regulators from taking the following actions:

(1) Terminating or limiting deposit insurance, or taking other adverse action against a depository institution under section 8 of the FDIC Act solely because the depository institution has or currently provides financial services to a CRLB or a CRLB service provider;

(2) Prohibiting or penalizing a depository institution from providing services to a CRLB or a CRLB service provider;

(3) Recommending, incentivizing or encouraging a depository institution not to offer financial services to an account holder solely based on its status as a current or future CRLB or a CRLB service provider (or owner, operator or employee thereof);

(4) Taking any adverse or corrective supervisory action on a loan made to a current or future CRLB or a CRLB service provider (or owner, operator or employee thereof), or lessors of equipment and real estate to CRLBs or their service providers; and

(5) Prohibiting, penalizing or discouraging a depository institution or entity performing services for the depository institution from authorizing, processing, clearing, settling, billing, etc., for a CRLB, where such payment is made by any means.

Section 3 of the Act would make it clear that proceeds from a transaction conducted by a CRLB or a CRLB service provider shall not be considered proceeds from an unlawful activity. As a consequence, these proceeds will be carved out from federal criminal statutes regarding money laundering and proceeds derived from unlawful activities.

Under the SAFE Banking Act (Section 4), a depository institution providing financial services to a CRLB or a CRLB service provider (and its officers, directors and employees) may not be held liable pursuant to any federal law or regulation solely because it provides these services or because it invests any income derived from these services.

Section 4 provides similar protections for insurers (and their officers, directors, and employees) that provide insurance for CRLBs or CRLB service providers or because it invests any income derived from these services.

A depository institution that takes a legal interest in collateral for a loan or other financial service provided to: (i) an owner, employee or operator of a CRLB or a CRLB service provider; or (ii) the owner or operator of real estate or equipment that is sold or leased to a CRLB or a CRLB service provider, will not be subject to criminal, civil or administrative forfeiture for making such loan or providing such financial service.

Medical Cannabis

The fiscal year 2020 omnibus spending legislation, recently signed by President Trump, continues the Rohrabacher-Farr amendment which was approved in 2014. The amendment prohibits the DOJ from interfering with the implementation of medical cannabis programs in those states where it has been authorized. This protection will remain in place until September 30, 2020.

Hemp

The Agricultural Improvement Act of 2018 (the "2018 Farm Bill") legalized hemp by removing it from the definition of cannabis as of December 20, 2018. The change applies to hemp with THC levels of less than 0.3%.

On October 31, 2019, the USDA issued an interim final rule establishing the domestic hemp production regulatory program to facilitate the legal production of hemp, as set forth in the 2018 Farm Bill.

Under the interim final rule, state departments of agriculture and tribal governments may submit plans for monitoring and regulating the domestic production of hemp to the USDA for approval within their respective territories.

Any such plan may impose restrictions beyond those set out in the interim final rule. However, these restrictions may not be less stringent than those established by the USDA.

Under the interim rule, in the absence of a state or tribal regulatory plan, hemp producers will be subject to regulation directly by the USDA. It should be noted, too, that a state or tribal government can prohibit hemp production within their respective territories.

Hemp businesses (like CRLBs) may experience difficulty gaining access to financial services.

To provide guidance to banks that wish to provide financial services to hemp related businesses, the Federal banking regulators issued a statement on December 3, 2019, to clarify the legal status of the

production of hemp and the requirement for banks under the BSA. FinCen is to issue additional guidance after reviewing the USDA interim final rule.

Because hemp is no longer a controlled substance under the CSA, banks are not required to file a SAR on customers solely because they are engaged in the growth or cultivation of hemp in accordance with applicable laws and regulations. For hemp-related customers, banks are expected to follow standard SAR procedures, and file a SAR if activities of the business warrant it.

Hemp related businesses will need to comply with various requirements to secure a license and to stay in compliance with the various regulations once a license has been secured. These post-license regulations can be quite onerous. They include, among other things: collecting information on the land used to grow the hemp; testing to make sure that the hemp stays below the 0.3% THC level; and disposing of plants that exceed the 0.3% THC level.

Banks must understand the state regulations in those states in which they operate, as well as the federal regulations if the state has not adopted a USDA approved program. A bank must satisfy itself that its customers have the proper licenses as there are different requirements for securing licenses for selling hemp seed, growing hemp and processing it. A bank must also ensure that the customer is complying with the various regulations once it secures the appropriate license.

For these reasons, a bank should consider expanding its know-your-customer policies and due diligence requirements for hemp businesses. Consideration should also be given to requiring additional certification forms from hemp clients. These forms can be utilized by company officers to affirm compliance with the testing, growing and other requirements that the company must address.

A bank should require a hemp related business to document its relationships with hemp seed sources, farmers and processors, as well as land use, and disposal of hemp plants that exceed the 0.3% THC level. This is particularly important if the customer is seeking bank financing for land, equipment or investment.

As with other customers, a bank must comply with applicable bank regulatory requirements such as customer identification, suspicious activity and currency transaction reporting, and proper risk-based customer due diligence. This includes the collection of required beneficial ownership information.

The SAFE Banking Act, if enacted, will also offer some protections for financial institutions that deal with hemp related businesses. It directs the Federal banking regulators within 90-days of the enactment of the SAFE Banking Act to issue guidance to financial institutions (including insurers) (i) confirming the legality of hemp-derived CBD products and other hemp-derived cannabinoid products and the legality of providing financial services to such businesses; and (ii) providing recommended best practices for financial institutions to follow when providing such services (Section 11 of the Act)..

In addition, Section 12 of the SAFE Banking Act provides that the other provisions of the Act (other than the requirement to file SARs) shall apply to hemp (including hemp-derived cannabinoid and other hemp-derived cannabinoid products) in the same manner as such provisions apply to cannabis.

Operation Chokepoint

In an effort to prevent the Federal banking agencies from restricting or discouraging a depository institution from providing services to a customer or group of customers operating in the same industry, Section 13 of the SAFE Banking Act prohibits a federal banking agency from directing a depository institution from entering into or maintaining a banking relationship unless (i) the agency has a valid reason; and (ii) such reason is not based solely on reputational risk. This provision is designed to prevent the banking regulators from restarting an earlier initiative known as "Operation Chokepoint" which

encouraged financial institutions to cease providing services to businesses that are looked on unfavorably by the regulators (like the gun industry and pay day lenders).

The SAFE Banking Act sets out procedures that have to be followed if a Federal banking agency makes a request that a depository institution terminate a customer's account or a group of customer accounts, including that the request be in writing setting forth a justification for such a request, and a requirement that notice be given to the customer or group of customers, unless such notice is excused under the provisions of the Act.

If you have any questions or comments, please feel free to contact Tim Sullivan (312-704-3852 or tsullivan@hinshawlaw.com) or Michael Morehead (217-467-4915 or mmorehead@hinshawlaw.com).

