HINSHAW

Alerts

The SAFE Banking Act: Financial Services for Marijuana and Hemp Businesses

June 5, 2023
Hinshaw Alert

I. Marijuana

Currently, 31 states plus the District of Columbia allow the recreational use of marijuana. In addition, 37 states and the District of Columbia currently allow marijuana to be used for medical purposes.

Despite this state legislation which covers more than half of the United States, marijuana remains a Schedule 1 controlled substance under federal law—The Controlled Substances Act (the CSA).

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

Further, individuals who own a marijuana business or who work for a marijuana business may also experience difficulty in securing banking services.

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

In addition, depository institutions providing services to such 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 2023 (the SAFE Banking Act or the Act) has been introduced in the U.S. Senate (S. 1323). The SAFE Banking Act sponsors include Jeff Merkley (D-OR); Steve Daines (D-MO); and David Joyce (R-OH-14). It has a number of cosponsors including a number of Republicans. It has also been introduced in the House. This or similar legislation has been introduced a number of times, has been passed by the House on a number of occasions, but has never been passed by the Senate. The SAFE Act enjoys

Attorneys

Timothy M. Sullivan

Service Areas

Business & Commercial Transactions

broad support from business groups, cannabis activists, and large swaths of the banking industry, including the American Bankers Association.

If now passed by the House, the legislation will move for passage 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 products and services to a State Sanctioned Marijuana Businesses (SSMB) and businesses that provide products or services to a SSMB (SSMB Service Provider).

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

A SSMB Service Provider is a business, organization, or other person that: (i) sells goods or services to an SSMB; or (ii) provides any business services, including the sale or lease of real or any other property, legal or other licensed services, or any other ancillary service, relating to an SSMB.

The SSMB Service Provider definition excludes a business, organization, or other person that participates in any business or organized activity that involves handling marijuana or marijuana products, including cultivating, producing, manufacturing, selling, transporting, displaying, dispensing, distributing, or purchasing marijuana or marijuana products.

The legislation also provides protections for insurance companies that provide insurance to SSMBs and SSMB 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 SSMBs or SSMB Service Providers.

"Financial products and services" would include services like checking accounts, payment cards, and electronic funds transfers and financial services as defined in Section 1002 of the Consumer Financial Protection Act of 2010. Such services also include:

(i) the business of insurance;

(ii) the authorizing, processing, clearing, settling, billing, transferring for deposit, transmitting, delivering, instructing to be delivered, reconciling, collecting, or otherwise effectuating or facilitating the payment of funds that are made or transferred by any means, including by the use of credit cards, debit cards, other payment cards, or other access devices, accounts, original or substitute checks, or electronic funds transfers;

(iii) acting as a money transmitting business that directly or indirectly makes use of a depository institution in connection with effectuating or facilitating a payment for a SSMB or SSMB Service Providers in compliance with section 5330 of title 31 of the United States Code (registration of money transfer businesses), and any applicable State or Tribal law; and

(iv) acting as an armored car service for processing and depositing with a depository institution or a Federal reserve bank with respect to any monetary instruments.

The SAFE Banking Act does not decriminalize marijuana on the federal level.

Furthermore, under the legislation, depository institutions are still responsible for ensuring they only provide financial products and services to SSMBs and SSMB Service Providers that are operating in compliance with applicable state or Tribal 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 SSMBs and SSMB Service Providers.

Depository institutions must also continue to comply with existing laws and guidance regarding suspicious activity reporting, such as the FinCen SARs rules. The Act directs the Secretary of the Treasury to amend existing guidance or issue new guidance 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), in consultation with the Treasury, to develop uniform guidance and examination procedures for depository institutions that provide services to SSMBs and SSMB 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 3 of the SAFE Banking Act provides a safe harbor for depository institutions by prohibiting federal banking regulators from taking the following actions:

- Terminating or limiting deposit insurance, or taking other adverse action against a depository institution under the FDIC Act or the FCU Act solely because the depository institution has or currently provides financial services to a SSMB or SSMB Service Provider;
- Prohibiting, penalizing, or otherwise discouraging a depository institution from providing services to a SSMB or SSMB Service Provider;
- 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 SSMB or SSMB Service Provider (or an owner, operator, or employee thereof);
- Taking any adverse or corrective supervisory action on a loan made to a current or future SSMBs or SSMB Service Providers (or an owner, operator, or employee thereof), or lessors of equipment and real estate to SSMBs or their SSMB Service Providers; and
- Prohibiting, penalizing, or discouraging a depository institution or entity performing services for the depository institution from authorizing, processing, clearing, settling, billing, etc., for SSMBs or SSMB Service Providers.

Section 4 of the Act would clarify that proceeds from a transaction conducted by a SSMB or a SSMB Service Provider shall not be considered proceeds from an unlawful activity. Consequently, 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 5(a)), a depository institution providing financial services to SSMBs or SSMB Service Providers (and its officers, directors, employees, and agents) 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 5(c) provides similar protections for insurers (and their officers, directors, and employees) that provide insurance for SSMBs or SSMB Service Providers or because it invests any income derived from these services.

A depository institution that takes a legal interest in the collateral for a loan or other financial service provided to: (i) an owner, employee, or operator of a SSMB or a SSMB Service Provider; or (ii) the owner or operator of real estate or equipment that is sold or leased to a SSMB or a SSMB Service Provider, will not be subject to criminal, civil or administrative forfeiture of the legal interest for making such loan or providing such financial service (Section 5(d)(1).

Federal lending agencies (e.g., FANNIE MAE) that take a legal interest in the collateral for a residential mortgage loan (1 to 4 family) underwritten in whole or in part based on income derived from a SSMB or a SSMB Service Provider will not be subject to criminal, civil or administrative forfeiture for providing, insuring, guaranteeing, purchasing, securitizing or guaranteeing payments from security based on such loan (Section 5(d)(3), as will non-depository lenders that make a federally backed mortgage underwritten in whole or in part based on income derived from a SSMB or a SSMB Service Provider and any person who has an interest in such loan or the collateral of such loan will receive similar protections (Section 5(d)(4)).

II. Federally Backed Single Family Mortgages

The Act (Section 9) also provides that income derived from a SSMB that operates within a State, an Indian Tribe, or a political subdivision of a State that allows the cultivation, production, manufacture, sale, transportation, display, dispensing, distribution, or purchase of marijuana pursuant to a law or regulation of the State, Indian Tribe, or political subdivision, as applicable, or a SSMB Service Provider, shall be considered in the same manner as any other legal income for purposes of determining eligibility for a federally backed mortgage loan for a 1- to 4-unit property that is the principal residence of the mortgagor.

The mortgagee or servicer of a federally backed mortgage loan described in the previous paragraph, or any Federal agency, the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation, may not be held liable pursuant to any Federal law or regulation solely for: (i) providing, insuring, guaranteeing, purchasing, or securitizing a mortgage to an otherwise qualified borrower on the basis of the income described in the previous paragraph; or (ii) accepting the income described in the previous paragraph as payment on the federally backed mortgage loan.

III. Medical Marijuana

The Consolidated Appropriations Act of 2023, signed by President Biden, 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.

IV. 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 percent.

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.

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

To guide 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.

On June 29, 2020, FinCen issued additional guidance to address questions related to BSA/AML for hemp-related businesses.

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 percent THC level; and disposing of plants that exceed the 0.3 percent 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 complies with the various regulations once it secures the appropriate license.

For these reasons, a bank should expand 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. Company officers can use these forms 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 percent 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 (Section 8), 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 (i) to address compliance by depository institutions relating to hemp-related businesses; and (ii) to provide recommended best practices for financial institutions to follow when providing such services to hemp-related businesses or hemp-related service providers.

In addition, Section 14 of the SAFE Banking Act provides that the other provisions of the Act (other than the requirement to file SARs) shall apply to hemp-related businesses or hemp-related service providers in the same manner as such provisions apply to marijuana.

V. 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 10 of the SAFE Banking Act prohibits a federal banking agency from formally or informally requesting or ordering a depository institution to terminate a specific customer account or group of customer accounts (including, but not limited to, any account of any customer that is a SSMB or a SSMB Service Provider) or to otherwise restrict or discourage a depository institution from entering into or maintaining a banking relationship with a specific customer or group of customers (including, but not limited to, with any customer that is a SSMB or a SSMB Service Provider).

In order to do this, the agency must make a valid written determination that the depository institution is (i) engaging in an unsafe or unsound practice; or (ii) violating a rule, law, regulation, or order with respect to the relationship of the depository institution with the customer (or, in the case of a group of customers, specific customers within the group); and (iii) such reason is not based primarily on reputational risk.

The SAFE Banking Act sets out procedures that must be followed if a Federal banking agency requests a depository institution to 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.

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).