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## Banking Cannabis in 2022

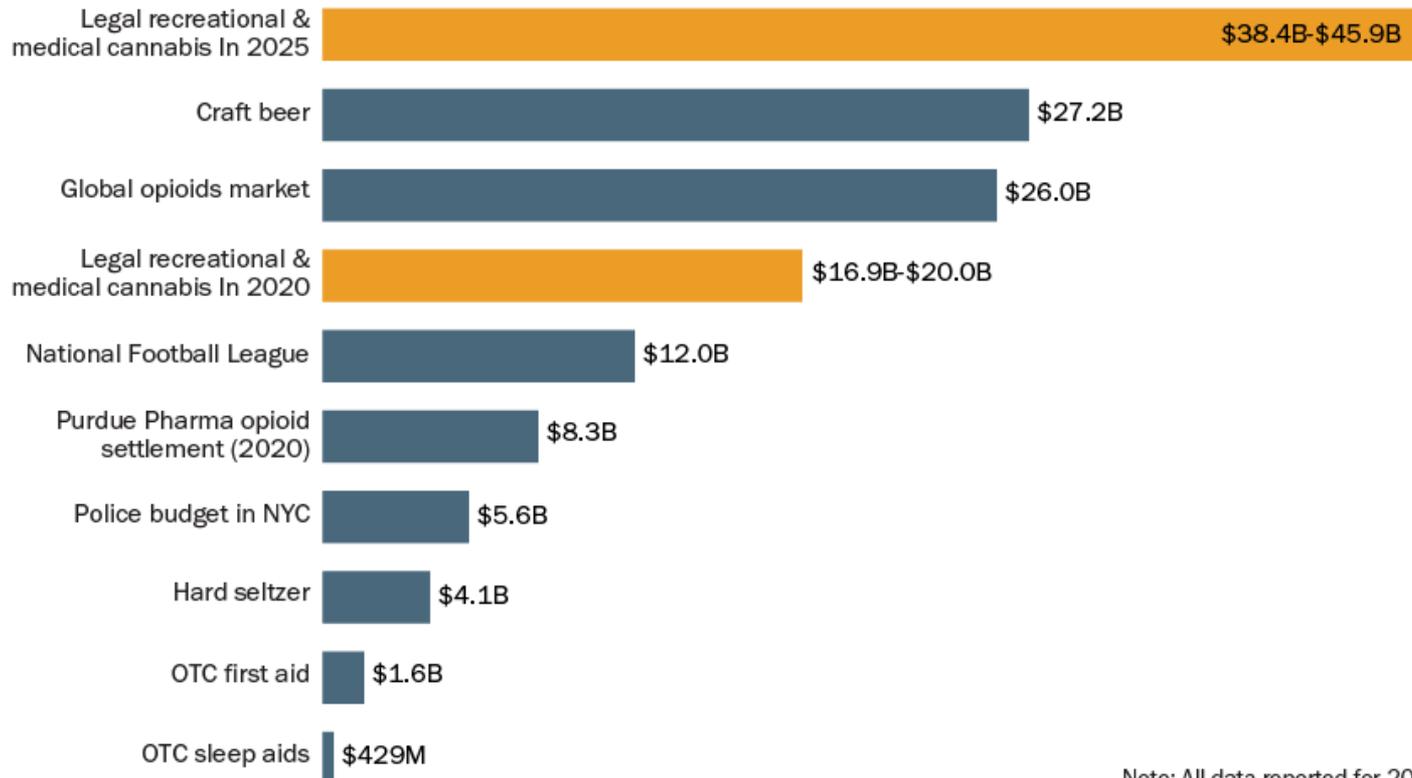
Virginia Bankers Association CFO Conference  
August 24, 2022



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# What's driving the cannabis push?

## U.S. Cannabis Sales Vs. Other Industries



Note: All data reported for 2020.

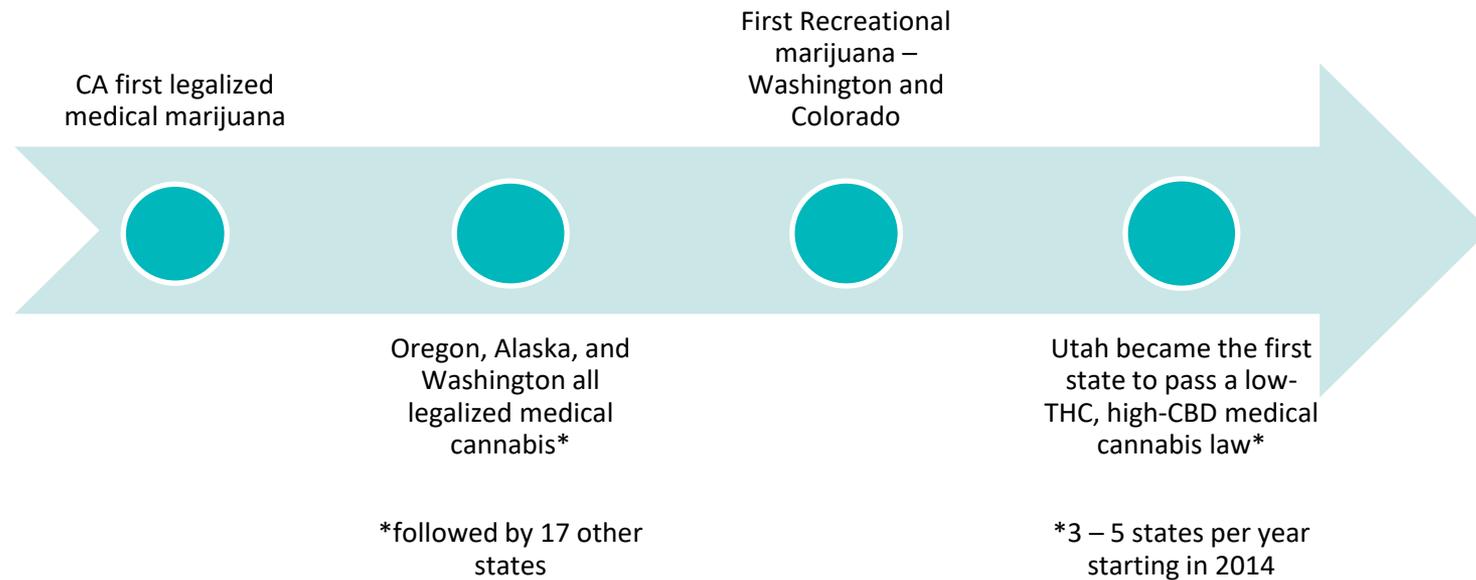
Source: NielsenIQ, Brewers Association, Consumer Healthcare Products Association, Grand View Research, Statista, Sports Business Journal, NPR  
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# What's driving the cannabis push?

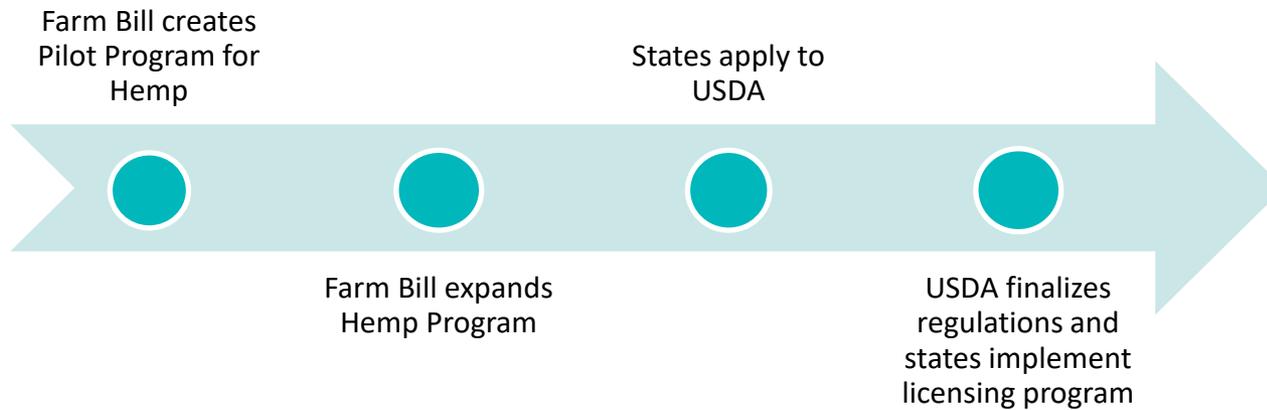
- Marijuana sales nationwide totaled \$25 bb in 2021, a growth of 40% over 2020 – BofA Securities
- From 2016 to 2020, the value of U.S. hemp fiber exports increased 1,112% - New Frontier Data
- In 2021, the value of hemp production for the U.S. totaled \$824 million. – USDA 2021 National Hemp Report
- As of late September, U.S. producers licensed an estimated 284,793 acres in 2021. That data reflects a 24% decrease from the 375,000 licensed acres reported to the U.S. Department of Agriculture's Farm Service Agency in 2020
- The US hemp-derived CBD market reached \$5.3 billion in 2021, an increase of 15% over sales in 2020 – Brightfield Group
- Looking ahead, says Brightfield, CBD sales will reach \$16 billion by 2026



# Timeline



# Timeline



# Why Do Banks Care?

- Accommodating customers
- General loan and deposit growth
- Marijuana transactions are cash transactions
- Fee income

# Why are banks concerned?

- Increased compliance
- Regulatory scrutiny
- Enforcement
- Civil and criminal liability?

# Barriers to Entry for Banks



- Federal Reserve access
- IRS implications –  
Section 280E
- Primary federal  
regulator supervision
- Enforcement
- Legislative Solutions

# Hemp and CBD

- Federal Farm Bill
- State law



# Cannabis: Marijuana vs. Hemp

Marijuana	Hemp
Marijuana is abundant in THC with concentrations between 15% to 40%	Hemp contains a very low concentration of THC (0.3% or less)
Marijuana is grown for recreational and medicinal purposes	Hemp is grown primarily for industrial purposes
Marijuana can be smoked, inhaled, ingested or injected directly into the body. THC is also commonly extracted from the plant and used in a variety of methods including vaporizers, capsules, edibles and more	Hemp's rapid growth and strong fibers made it ideal for crafting durable rope, clothing, sail, and paper. With the fast-growing popularity of CBD, hemp is also used to produce a wide variety of THC-free CBD products
Still a schedule I drug under the federal Controlled Substances Act	<u>No longer</u> a Schedule I drug under the federal Controlled Substances Act as of December 20, 2018
Still a schedule I drug under the Virginia Drug Control Act	<u>No longer</u> a Schedule I drug under the Virginia Drug Control Act as of March 2019

## Marijuana:

- Still a Schedule I drug under the Federal Controlled Substances Act
- Cole Memos (rescinded by Attorney General Sessions in 2018)
- Financial Crimes Enforcement Network (FinCEN) Guidance on Marijuana SARs
- Multiple bills working through Congress (SAFE Act; STATES Act)
- State legislative efforts: VA Code Section 6.2-107.1

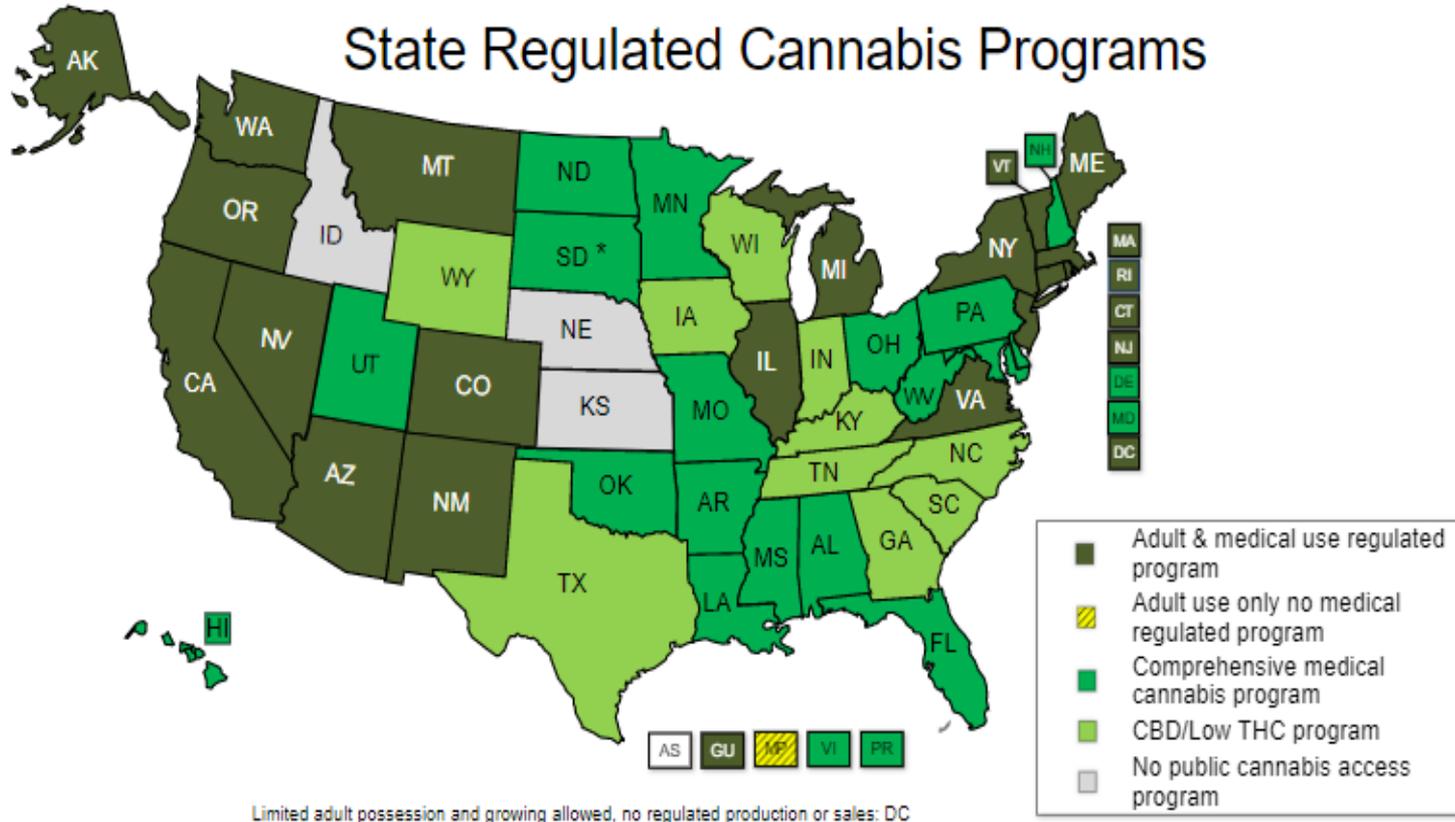
## Hemp:

- NOT a schedule I drug under the federal Controlled Substances Act
  - 2018 Farm Bill removes hemp (hemp cannot contain more than 0.3 percent of THC) from the Controlled Substances Act

## Marijuana

- Legality under state law varies by states –
  - 3 states still fully illegal (Idaho, Kansas, Nebraska)
  - 19 States + D.C. – Fully Legal (recreational and medical)
  - 37 states with legalized medical marijuana use in some form (some of these with extremely limited medical use, physician prescription requirements, and CBD oil use in many of these states limited to treatment for intractable epilepsy) (some overlap with 19 fully legalized states and D.C.) – most other states have specific CBD Oil laws
- Multiple bills in state legislatures

# State by State



May 2022

Source: NCSL (National Conference of State Legislatures)

## Hemp:

- All states now either have approved plans or producer licenses
- Since so many states have restrictions on sale of CBD oil in terms of entities licensed to sell, requirement of prescriptions and similar restrictions, retailers selling over-the-counter CBD oil products risk state/local law enforcement action
  - Ex. Pell City, Alabama May 2022 raid on CBD oil shop

# What about CBD Stores and Retailers Selling CBD Products?



# What about CBD Oil and other CBD Products?

- 2018 Farm Bill did NOT make sale of CBD oil products legal in all 50 states
- Many states have highly restrictive laws around sale of CBD oil, and unless a retailer is licensed and following rules for prescription vetting or registration card vetting for purchasers, may be violating state laws that require that – over-the-counter sale in a state that has a highly regulated licensing regime for CBD oil sales could lead to violations
  - Ex. Bellevue, NB store selling CBD oil products told to cease and desist sale by county attorney (Dec. 2018)
- Payment processing and “transaction laundering”:
  - Ex. March 14, 2019, Elavon (a payment processing subsidiary of U.S. Bank), notified its hemp and CBD clients that per card network and U.S. Bank instructions, hemp and cannabidiol-based merchants are now a prohibited business type and that accounts for such merchants would be closed within 45 days.
  - “Pace of an evolving Federal and State regulatory framework makes it extremely difficult to validate the qualifications required to operate within this industry” per Elavon

## CBD Oil:

- Legality under state law varies by states –
  - ❖ States with laws permitting retail sale (Colorado, North Carolina, South Carolina)
  - ❖ Industrial hemp legal, no laws re CBD (DC, Oklahoma)
  - ❖ Industrial hemp legal, laws prohibiting CBD retail sales (Texas)
  - ❖ Industrial hemp legal, laws permitting CBD for medical purposes (Virginia)
- Multiple bills working through the state legislatures in 2019
- CBD oil products risk state/local law enforcement action

# CBD Oil Products and Federal Food and Drug Administration - FDA

*“Nonetheless, the misperception persists that all products made from or containing hemp, including those made with CBD, are now legal to sell in interstate commerce. The result has been that storefronts and online retailers have flooded the market with these products, many with unsubstantiated therapeutic claims. FDA has seen CBD appear in a wide variety of products including those purporting to be foods, dietary supplements, veterinary products, and cosmetics. As this new market emerges, we have seen substantial interest from industry, consumers, and Congress. However, FDA’s role remains the same: to protect and promote the public health.*

***At present, any food containing CBD or purported CBD dietary supplement product in interstate commerce is in violation of the FD&C Act...”***

- Dr. Douglas Throckmorton, Deputy Director of FDA, testimony to Congress January 2020

# CBD Oil Products and Federal Food and Drug Administration - FDA

April 2, 2019: FDA is announcing a number of important new steps and actions “to advance our consideration of a framework for the lawful marketing of appropriate cannabis and cannabis-derived products under our existing authorities.”

- A public hearing on May 31, as well as a broader opportunity for written public comment, for stakeholders to share their experiences and challenges with these products, including information and views related to product safety.
- The formation of a high-level internal agency working group to explore potential pathways for dietary supplements and/or conventional foods containing CBD to be lawfully marketed; including a consideration of what statutory or regulatory changes might be needed and what the impact of such marketing would be on the public health.
- Updates to FDA website with answers to frequently asked questions on this topic to help members of the public understand how the FDA’s requirements apply to these products.
- **The issuance of multiple warning letters to companies marketing CBD products with egregious and unfounded claims that are aimed at vulnerable populations as recently as May 2022**
  - Some in collaboration with the Federal Trade Commission



- Controlled Substances Act
  - Marijuana is a Schedule I drug subject to federal criminal prosecution under the Controlled Substances Act
  - It is illegal to aid and abet the manufacture, distribution, or dispensing of marijuana

- **Anti-Money Laundering Statutes**
  - An offense committed knowingly to promote an unlawful activity or to conceal the nature, source, or ownership of funds from a specified unlawful activity is money laundering
  - “Manufacture, importation, sale, or distribution of a controlled substance” is listed as a “specified unlawful activity”





- **The Cole Memo**

- On August 29, 2013, DOJ Deputy Attorney General James M. Cole provided guidance regarding marijuana enforcement
- While continuing to conclude that marijuana is a “dangerous drug and that the illegal distribution and sale of marijuana is a serious crime,” the DOJ committed to “using its limited investigative and prosecutorial resources to address the most significant threats in the most effective, consistent, and rational way.”

# Enforcement Relief For Banks?

## Eight 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 where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;



# Enforcement Relief For Banks?



- 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;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

# Enforcement Relief For Banks?

- Priorities will guide the DOJ's enforcement actions
- However, the DOJ's authority to enforce federal law remains regardless of state law
- Cole Memo specifically stated that neither it, nor any state or local law "provides a legal defense to a violation of federal law"

# Enforcement Relief For Banks?



## FinCEN Memo

“This FinCEN guidance clarifies how financial institutions can provide services to marijuana-related businesses consistent with their BSA obligations, and aligns the information provided by financial institutions in BSA reports with federal and state law enforcement priorities. This FinCEN guidance should enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses.



- **“Marijuana Limited” SAR filings if:**
  - A financial institution is providing financial services to a marijuana-related business that it reasonably believes, based on its customer due diligence, does not implicate one of the Cole Memo priorities or violate state law
  - Continuing activity reports

- **“Marijuana Priority” SARs filings if:**
  - A financial institution is filing a SAR on a marijuana-related business that it reasonably believes, based on its customer due diligence, implicates one of the Cole Memo priorities or violates state law should file a “Marijuana Priority” SAR
- **“Marijuana Termination” SAR filings if:**
  - A financial institution deems it necessary to terminate a relationship with a marijuana-related business in order to maintain an effective anti-money laundering compliance program

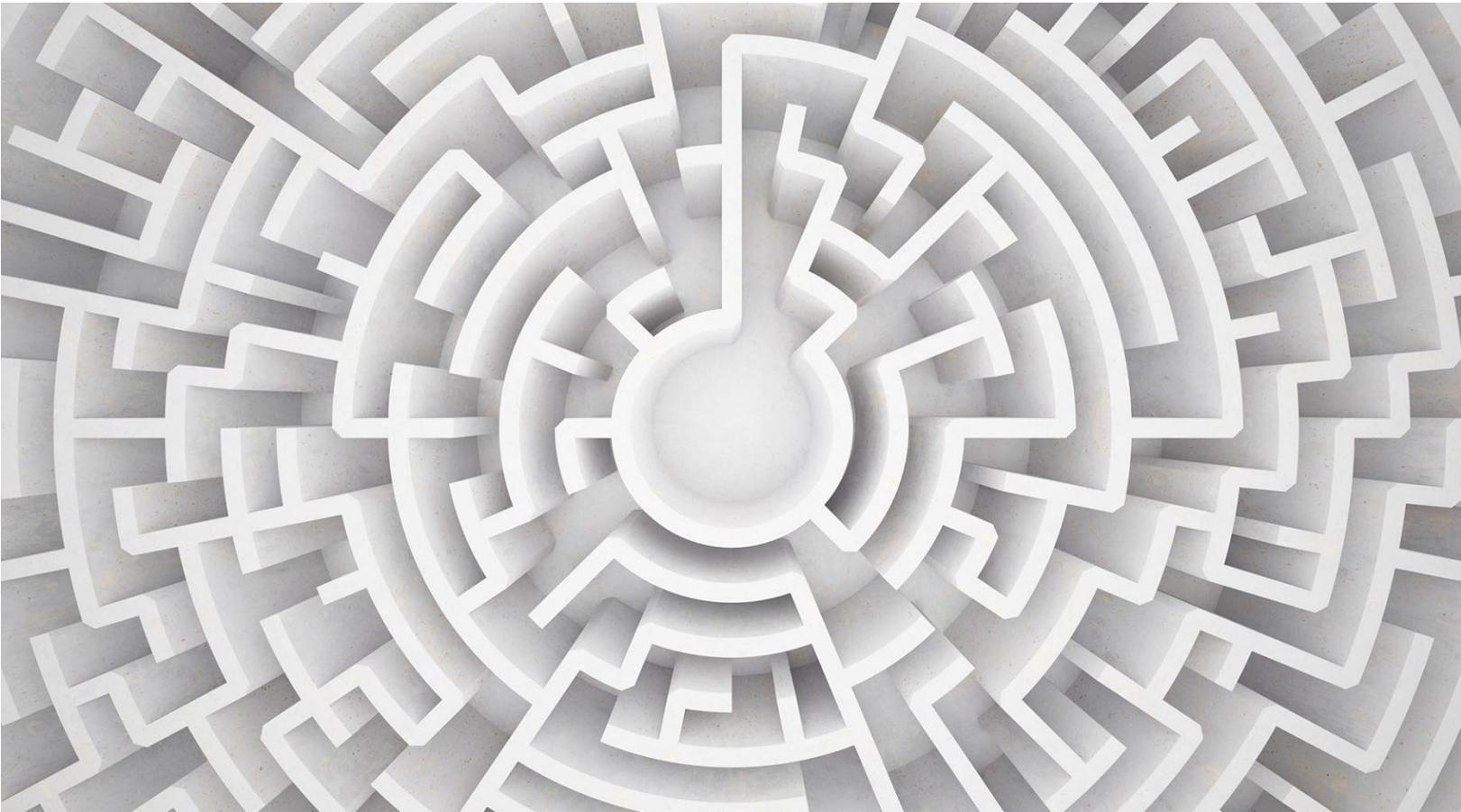


# SAFE Banking Act

- Prevents federal banking regulators from taking action against banks *solely* for providing banking services to cannabis related businesses if its legal in the state
- Protects ancillary businesses like real estate owners, accountants and other vendors from money laundering and other federal laws for taking funds from such legally-operating cannabis businesses, including money transmitters
- Prohibits any criminal, civil or administrative forfeiture in connection with legal collateral rights that depository institutions have in connection with loans that they make to legally-operating cannabis businesses or related ancillary businesses
- Seventh time is a charm?



- 12/19 guidance on Providing Financial Services to Customers Engaged in Hemp-Related Businesses
- Various states' regulatory guidance: Texas, Illinois, etc.
- 6/20 FinCEN guidance
- Takeaway: strong compliance, particularly with respect to BSA/AML





- Goal is to broadly define what the bank must do to conduct the activity in safe and sound manner
- Determine risks associated with activity and whether they can be sufficiently mitigated
- Conclusions drive whether the returns justify the activity



- The risk assessment is fundamental to the initial decision of whether or not to enter into a third-party relationship
- Ensure that the proposed relationship is consistent with the institution's strategic planning and overall business strategy
- Analyze the benefits, costs, legal aspects, and the potential risks associated with the third-party under consideration
- Management review of management's ability to provide adequate oversight and management of the proposed third-party relationship on an ongoing basis
- Carefully estimate the long-term financial effect on the institution of the proposed third-party relationship
- The risk assessment informs testing



## Risk Assessment of:

- Strategic
  - How does the activity fit with the strategic plan?
  - Consider the likely returns and impact of compliance controls on the income stream
- Credit
- Operational
  - Honest misdirection of funds
- Compliance
- Transactional
- Legal
- Reputation
- Fraud
  - Misappropriation of funds – ill intended
- Third-party risk



# Customer Due Diligence Requirements



- FinCEN Memo:
  - 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 hemp-related business;
  - Requesting from state licensing and enforcement authorities available information about the business and related parties;

# Customer Due Diligence Requirements

- Developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus recreational customers);
- Ongoing monitoring of publicly available sources for adverse information about the business and related parties;
- Ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance;
- Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk; and
- Also FinCEN four pillars of EDD/CDD.



# Customer Due Diligence Requirements



- The FinCEN Memo also directs banks to consider whether a marijuana-related business implicates one of the Cole Memo priorities or violates state law.
- Use this as a baseline for CDD



# Monitoring and Testing



- Depositing more cash than is commensurate with the amount of hemp-related revenue it is reporting for federal and state tax purposes
- Rapid movement on funds, such as cash deposits followed by immediate cash withdrawal
- Deposits by third parties with no apparent connection to the accountholder
- Excessing commingling of funds with the personal account of the business's owner(s) or manager(s)
- Financial statements provided by the business to the financial institution are inconsistent with actual account activity

# Monitoring and Testing

- The business is unable to produce satisfactory documentation or evidence to demonstrate that it is duly licensed and operating consistently with state law
- The business is unable to demonstrate the legitimate source of significant outside investments
- Review of publicly available sources and databases about the business, its owner(s), manager(s), or other related parties, reveal negative information, such as a criminal record



# Monitoring and Testing



- A business engages in international or interstate activity, including by receiving cash deposits from locations outside the state in which the business operates

# Contract Provisions and Considerations



- Supplemental deposit agreement
  - Activity limits
  - Indemnification
  - Customer obligations
  - Certifications – compliance with laws and agreements

# Next Steps

- Determine the status of the law in your state
- Start the risk assessment to determine whether to engage in activity
- Change strategic plan
- Add staff, if necessary, to perform due diligence, customer risk assessments, on boarding and monitoring
- Review the bank's CMS to make sure all of the elements are in place
- Then build-out CMS elements specific to hemp activity, delivery procedures and contracts to protect the bank.



- Increased regulatory scrutiny of corporate governance, tighter examinations and more frequent remedial actions
- Higher risk activity means enhanced compliance scrutiny
- Be prepared, including homework
- To do it well, strong risk oversight function

# Questions?

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