

# Clients & Friends Memo

## Cannabis Finance - SAFE in the STATES and Maybe Beyond?

April 8, 2019

Will 2019 be the year that federal lawmakers block U.S. law enforcement and regulatory agencies from enforcing marijuana prohibitions in states where marijuana is legal and finally resolve the divergence between state and federal law regarding marijuana? Two bills currently making their way through Congress suggest this might be the case.

### The SAFE Act

On March 28, 2019, the House Financial Services Committee voted, 45 to 15, to advance a revised version of the SAFE Banking Act, H.R. 1595, the [Secure and Fair Enforcement Banking Act of 2019](#) (the "SAFE Act"), to the full House of Representatives for a vote. A hearing on the bill was held last month. Although a version of the bill was introduced six years ago, this is the first time that testimony was taken and a committee vote held on access-to-banking legislation. The SAFE Act has yet to be scheduled for consideration by the House, but with 150 sponsors, it is expected that it will come to a vote soon, after a review by the House Judiciary Committee.

Currently, federal money laundering statutes define any transaction involving the proceeds of the manufacture, distribution or sale of marijuana to be illegal, even if the transactions are legal within the state or country in which they occur. Thus, banking regulations in effect today prohibit depository institutions entering into financial transactions or accepting account relationships involving illegal proceeds. At a minimum, FinCEN requires any transactions with illegal [marijuana] proceeds to be reported as suspicious. The specter of filing a suspicious activity report ("SAR") for a client has been enough to dissuade many financial institutions from taking on marijuana-related businesses as clients, and has led banks to close accounts for any depositors suspected of having revenue from the cannabis industry.

Given the lack of access to banking services, cannabis has been largely a cash business. As a result, piles of currency sit in dispensaries and are carted around by armored trucks for delivery to warehouse vaults and other sites – at tremendous risk to drivers and others responsible for storing the money. Cash transactions also invite lack of transparency; for example, it is impossible for governments to ascertain whether all revenue is being tax-reported in these booming businesses.

If passed, the SAFE Act would provide a safe harbor from federal money laundering and regulatory prosecutions for insured depository institutions that supply financial services to cannabis-related legitimate businesses and their service providers. The SAFE Act would prohibit federal banking regulators from terminating deposit insurance, penalizing or even discouraging, depository institutions from providing financial services to a cannabis-related legitimate business or service provider.

Most of the substance of the bill is focused on “depository institutions,” which is in turn defined to mean FDIC-insured banks, thrifts and credit unions. However, the bill will also directly or indirectly benefit other types of financial institutions. For example, Section 2(5) of the bill gives relief for an entity performing a “financial service for in or in association with a depository institution.”

Even more significantly, Section 3 of the bill would effectively amend the federal anti-money laundering laws by providing that the proceeds of a cannabis-related legitimate business shall not be considered as proceeds from an unlawful activity. This would protect, among other activities, real estate finance of marijuana properties, broker-dealer custody of cannabis-related stocks and their receipt of dividends paid on those stocks. It would seem logical that if the money flowing *out* of a cannabis-related business is not proceeds from an unlawful activity that any otherwise legitimate money flowing *into* a cannabis-related business should also not be deemed to be the proceeds of unlawful activity.

Section 3 of the bill is the provision that is likely to have the most profound impact beyond the financial services industry, as banks and other financial institutions will no longer be at risk of prosecution for money laundering if they service many cannabis-related businesses. Many industries have grown up around legal cannabis businesses, and more will likely emerge given the potential loosening of the law. Investment activity in these ancillary businesses is likely to explode.

Large national and international banks, many of which are currently subject to cooperation and compliance obligations as a result of past corporate settlements with the Department of Justice, have balked at entering the cannabis-finance space. The SAFE Act should ease the reluctance of banks to provide certain financial services. Surely, a huge beneficiary of the proposed legislation will be service providers to cannabis-related legitimate businesses. The landscape for service providers has been particularly fraught, with their access to banking being severely limited no matter how far from the cannabis plant the service in question might have been. The extension of the safe harbor to those businesses should give banks additional comfort that these businesses can be accepted as customers.

The bill directs the GAO to study the marijuana-related SARs filed to date, and assess the effectiveness of such SARs in identifying bad actors. Finally, the bill requires the federal banking regulators to report to Congress annually on specified matters and requires the GAO to study

barriers to marketplace entry and access to financial services by minority-owned and women-owned cannabis-related legitimate businesses.

### **The STATES Act**

Of broader reach than the SAFE Act, on April 4, 2019, a bipartisan team of legislators re-introduced companion versions of the Strengthening the Tenth Amendment Through Entrusting States Act (the “STATES Act”) in both the Senate and the House. The STATES Act would amend the Controlled Substances Act (the “CSA”) to restrict federal enforcement against state-legal cannabis activity. In particular, the bill prevents the application of the Controlled Substances Act to individuals or companies acting in compliance with state law relating to the manufacture, production, possession, distribution, dispensation, administration, or delivery of marijuana.

In addition, the law would prevent forfeiture of any assets derived from state-legal marijuana business and would exempt state-legal marijuana business from the definition of “specified proceeds of illegal activity” under the money laundering laws. In announcing the bill, Rep. David Joyce said that “current federal policy interferes with the ability of states to implement their own cannabis laws, and the resulting system has stifled important medical research, hurt legitimate businesses and diverted critical law enforcement resources needed elsewhere.” The STATES Act was introduced in Congress in 2018, and President Trump commented that he would “probably end up supporting that” despite the well-known opposition of his then-Attorney General Jeff Sessions.

The STATES Act would be a significant step toward eliminating the issues posed by dueling federal and state law with regard to cannabis. Not only does the STATES Act provide that the CSA is inapplicable to state-legal cannabis activities, it would make clear that federal money laundering and asset forfeiture laws are inapplicable to funds derived from state-legal cannabis activities. If enacted, this law would go further than any other bill introduced to date, including the SAFE Act, to remove the significant hurdles that exist for state-compliant businesses and individuals to expand their cannabis businesses. Most importantly, it would likely remove a number of issues for all financial institutions – not just depository institutions or their affiliates – that have, to date, prevented many financial service providers from engaging in transactions with cannabis businesses. Although the STATES Act does not specifically mention the Bank Secrecy Act, it is likely that the current FinCEN SAR regime for marijuana-related businesses would become moot and SARs would only be required in the case of non-state compliant cannabis business activities.

Also of note, in announcing the reintroduction of the legislation, Rep. Joyce cited studies lauding cannabis use as a possible solution to the opioid crisis. In joining the two issues, Joyce highlighted the national angst about addiction-related deaths and likely increased the level of support the two bills are likely to engender in Congress.

**To Come**

It remains to be seen if and when either bill will come to the House floor for a vote. The Judiciary Committee still needs to weigh in on the SAFE Act, and the STATES Act has not been scheduled for a hearing. And of course, even assuming passage in the House, there is still the Senate, which seems less inclined to pass either bill. However, with 47 states and the District of Columbia having legalized cannabis in some way, it seems hard to think that one or both of these bills will not advance.

Some words of caution though – neither bill fully legalizes cannabis. Both apply their safe harbor and exemption prohibitions exclusively to state-legitimate or state-compliant businesses. In other words, even with the safe harbor firmly established, banks and service providers are permitted to service only “legitimate” cannabis-related businesses. The level of diligence that will be sufficient to establish that the cannabis-related business is demonstrably legitimate so as to qualify for the safe harbor protections is not certain, but it can be assumed that standards of KYC compliance under the Bank Secrecy Act would apply. This would require, at a minimum, that a financial institution take measures to investigate whether its client is operating within the bounds of local law. With numerous highly technical state and local laws governing individual cannabis businesses, ascertaining a cannabis-related business’s compliance with those laws will present a challenge going forward, but likely one that is worth the effort. Recent estimates suggest that within a few short years, the domestic legal cannabis industry could generate tens of billions of dollars in annual revenue.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Jodi Avergun	+1 202 862 2456	<a href="mailto:jodi.avergun@cwt.com">jodi.avergun@cwt.com</a>
Steven Lofchie	+1 212 504 6700	<a href="mailto:steven.lofchie@cwt.com">steven.lofchie@cwt.com</a>
Mark Chorazak	+1 212 504 6565	<a href="mailto:mark.chorazak@cwt.com">mark.chorazak@cwt.com</a>