

Attorneys Sara McNamara and James Sheriff author article on Banking and the Cannabis Industry

This article is a continuation of an article originally published by the authors in the March 2019 issue of the *Wisconsin Bankers Association* ("WBA") magazine.

The previous article highlighted some of the high-level questions and answers bankers may have regarding the current state of the law on cannabis. The following are additional questions and answers that provide more information and further detail on cannabis issues relevant to financial institutions.

What is the status of Marijuana/Cannabis Under Federal Law?

Marijuana is classified as a "Schedule I" drug, the most dangerous category, under the federal Controlled Substances Act. Pursuant to the CSA, the possession, manufacture, and distribution of marijuana is illegal and may result in very substantial civil fines and criminal penalties. Other parties assisting in this activity can be prosecuted under federal law.

In 2005, the United State Supreme Court held that under the Commerce Clause, Congress was authorized to prohibit the local growing and use of cannabis, despite a state law (California) to the contrary. "Any local laws that authorize conduct prohibited by federal law (e.g., the cultivation of pot under a state law permitting this) ... raise serious questions of federal preemption and is an "obstacle" and is therefore preempted." (214 Cal. App. 4th 1545 (2013).

What is the Cole Memo and how is it relevant under the current legal landscape?

As mentioned in the previous article, [the Cole Memo](#) is referenced frequently in articles discussing the legality of cannabis. The Cole Memo was published by former US Attorney General James Cole in 2013. The memo adopted a hands-off approach to prosecuting cannabis offenses in states with legal marijuana laws. The Cole Memo indicated that prosecutors and law enforcement should focus only on preventing:

- the distribution of marijuana to minors;
- revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;

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- the diversion of marijuana from states where it is legal under state law in some form to other states;
- state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- violence and the use of firearms in the cultivation and distribution of marijuana;
- drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- marijuana possession or use on federal property.

The foregoing are often referred to as the "Cole Memo Priorities". After the Cole Memo was issued, federal prosecutions for marijuana-related offenses dropped significantly. However, in January of 2018, then US Attorney General Sessions rescinded the Cole Memo and called the shift a "return to the rule of law." Sessions, in a written memo, said that prosecutors should follow "the well-established principles that govern all federal prosecutions." While Sessions did not explicitly direct prosecutors to increase or devote more resources to cannabis-related prosecutions, the rescission of the Cole Memo left many people unsure of how to reconcile federal prosecutions with state legalization efforts. The Cole Memo Priorities are often cited and referred to today as if they were still in effect and play an important role in determining the appropriate SAR Filings required for financial institutions, which is discussed in more detail below.

How does Attorney General nominee William Barr view the Cole Memo?

On January 15, 2019, President Trump's nominee for US Attorney General, William Barr, testified in front of the US Senate. In that testimony, Barr stated that if he is appointed as Attorney General, marijuana-related businesses operating legally under state laws will not face prosecution or punishment by the Department of Justice. Specifically, Barr stated "I'm not going to go after companies that have relied on [the] Cole memorandum." Barr also criticized Congress by noting that they either needed to adopt a realistic federal approach or allow states to have their own laws as the way the system is operating now is akin to "a backdoor nullification of federal law." If appointed, Barr's approach would in effect be another reversal of the position taken by Jeff Sessions, and ultimately, could have

an impact on how cannabis-related businesses are viewed moving forward.

Can a financial institution terminate an employee if the employee engaged in marijuana-related activity in a state (e.g. Michigan and Colorado) that have legalized the recreational use of cannabis? Does it matter if the branch location and employee are both located in such state?

Yes, an employer may terminate an employee who violates the employer's code of conduct prohibiting the use of marijuana. As federal law preempts state law, the employer's policy will trump the employee's rights under state law. Several U.S. Circuit Courts of Appeals, including the Sixth Circuit which includes Michigan, have affirmed these rulings. It does not matter if the branch or employee are located in that state.

How should our financial institution handle a marijuana related business?

This should be a subject that, in our opinion, is fully discussed with your Board of Directors who can appreciate the risks and rewards and make an informed judgment.

Financial institutions have followed three major paths:

1. Never provide products or services to a marijuana business.
2. Bank certain marijuana-related businesses on a special, limited exception business.
3. Actively look to bank marijuana businesses.

In 2018, the Financial Crimes Enforcement Network reported that approximately 411 insured banks and credit unions nationwide have filed forms requesting to do business with marijuana-related businesses. In fact, several legal marijuana businesses now accept debit cards, which indicates they have found banks to work with them. However, it is still uncommon for a marijuana business to disclose the banks they are working with, but the banks that are doing this have decided to assume the added risk in order to reap significant benefits. Due to the complex regulations, banks and credit unions are able to charge a significant premium to marijuana-related business such that the fees are often three to four times higher than the fees a non-marijuana business would expect to pay.

What states have legalized marijuana, either for medical or recreational purposes?

[This map](#) shows the states that have acted to date to legalize marijuana in some manner. The District of Columbia and ten other states have adopted broad laws allowing the recreational use of marijuana. Note that the only state in the Midwest to fully legalize the use of marijuana is Michigan; its law became effective on January 1, 2019.

An agricultural banker told us, "One of my good farm borrowers recently told me he wanted to shift 25% of his grain and corn production to growing hemp. He told me that growing and distribution of hemp in Wisconsin is now legal since December 2018, and he saw excellent opportunities here to lend. The borrower wanted to know whether the bank would finance his necessary costs and growth into this new market. What should I tell him and my Board of Directors about financing hemp?"

There have been a number of recent actions taken by both the United States and Wisconsin to loosen the regulation of the production and marketing of "hemp," a low-grade form of cannabis. Hemp is defined as a product which has less than 0.3 percent of THC concentration, which is the psychoactive part of cannabis. In December 2018, President Trump signed the Agriculture Improvement Act into law. This law expressly removed hemp from the Controlled Substances Act, meaning that hemp is no longer an illegal substance under federal law.

In May of 2018 Wisconsin, through its Department of Justice, issued new guidance announcing the terms of a new industrial hemp program that would be legal. This program, administered by the state's Department of Agriculture, Trade and Consumer Protection ("DATCP"), allows a Wisconsin farmer to obtain a permit to grow and sell industrial hemp. A farmer following these rules is exempt from criminal prosecution and any products made from industrial hemp are lawful. (The recent federal law taking hemp off the CSA list reinforces this conclusion).

The Wisconsin Department of Justice's guidance provides that farmers may:

- (a) grow industrial hemp without fear of criminal prosecution;
- (b) sell the entire hemp plants or parts of the plant to anyone; and
- (c) process the plant as permitted by DATCP's rules and regulations, which includes producing CBD.

In a recent *Wall Street Journal* article discussing the upswing in national hemp production for many of the reasons discussed above, Wisconsin is listed as a top-

ten state in production, and one of the only Midwest states listed.

When must a "Suspicious Activity Report" ("SAR") be filed by financial institutions under The Bank Secrecy Act in connection with transactions with marijuana-related business? Can you explain the required SAR filings in more detail?

Under the Bank Secrecy Act ("BSA"), financial institutions are required to file a Suspicious Activity Report ("SAR") when the institution encounters suspicious or potentially suspicious activity, including known or suspected violations of law. As the legalization of marijuana became more prevalent under state law, financial institutions began to have questions regarding if and when a SAR needed to be filed in connection with a known or suspected cannabis related transaction.

In February of 2014, the Financial Crimes Enforcement Network ("FinCEN") issued guidance clarifying its expectations for financial institutions intentionally or inadvertently providing services to marijuana-related business. In its guidance, FinCEN noted that the decision to open, close or refuse any particular account or relationship should be evaluated by the financial institution on a case by case basis. The financial institution should take into account the risks associated with offering a product or service to certain customers and its ability to manage those risks effectively.

Specifically, FinCEN stated that a financial institution should consider whether a marijuana-related business violates state law or implicates one of the Cole Memo Priorities. Regardless of whether the financial institutions decide to provide services to a marijuana-related business, they are still required to file a SAR on activity involving such business even if the activity is duly authorized under state law.

FinCEN identified three types of SARs that may be filed for cannabis-related activity: (1) Marijuana Limited, (2) Marijuana Priority and (3) Marijuana Termination.

A Marijuana Limited SAR should be used if a financial institution believes the customer's activities do not implicate one of the Cole Memo Priorities or violate state law. The content of the SAR should be limited to (a) identifying the subject and related parties and their respective addresses, (b) noting that the SAR is being filed solely because the subject is engaged in a marijuana-related business and (c) indicating that no additional suspicious activity has been identified. In the narrative section of the SAR, the term "MARIJUANA LIMITED" should be used.

A Marijuana Priority filing should be used if the financial institution believes that the customer's activities do implicate the Cole Memo priorities or violate state law. In addition to the names and addresses of the subject and related parties, this SAR filing should provide details regarding the Cole Memo Priorities the financial institution believes have been implicated and the dates, amounts and other relevant details of the suspicious transactions. In the narrative section of the SAR, the term "MARIJUANA PRIORITY" should be used.

Finally, a Marijuana Termination filing should be used if the financial institution terminates the customer relationship in order to comply with its anti-money laundering compliance program. In addition to the requirements of the Marijuana Priority filing, this SAR filing should note the basis for the termination.

The [FinCEN guidance](#) provides additional details and red flags financial institutions can look for in determining whether a customer has violated state law or implicated one of the Cole Memo Priorities.

In addition to federal and state law addressing marijuana, are there local laws and ordinances as well that relate to this subject?

Yes, in most states where marijuana production, distribution, and use have been legalized, local municipalities have passed a number of marijuana-related laws that would need to be reviewed by a grower, distributor or a financial institution looking to finance that party.

If your institution has made a decision to avoid entirely any involvement (even inadvertent) with a marijuana-related business, what are some recommended steps?

A financial institution looking to totally avoid involvement with marijuana-related business should include language in their loan documentation expressly prohibiting its customer from engaging in any marijuana-related business. In other words, if a customer engages in marijuana activities it would be a default or breach under its applicable agreements with the financial institution.

Are marijuana related businesses required to be licensed under state or local law?

Almost all states that permit some form of marijuana use or growing will require licensing and regulatory approvals to be obtained at both the state and the local level. These licenses, and reporting requirements, fees, compliance with environmental ordinances, and paying for state compliance audits, can be very



costly and burdensome. The total cost for a start-up operation, in a highly regulated state like California, is reported to be more than \$100,000.

Assume a financial institution has a mortgage on property used by a commercial borrower as a warehouse. Unknown to the financial institution, the borrower is using part of the warehouse to store cannabis and is not properly licensed. After a loan default, the institution seeks to foreclose on the warehouse. Does this present any risks or problems?

Yes, due to the illegal criminal activity conducted on the property, the bank would be advised not to proceed with the foreclosure. Note that numerous bankruptcy cases filed by marijuana business debtors have been dismissed by the U.S. Bankruptcy Courts due to the activities of the debtor being in violation of federal law.

In sum, there are many complexities that come with banking a marijuana related business. If you have additional questions or would like to learn more please contact Jim Sheriff or Sara McNamara.

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