In this Issue

Letter from the Editors

Preventing Predation & Encouraging Innovation in Fintech Lending
Matthew Adam Bruckner

Current Banking Issues in the Cannabis Industry
Barry A. Abbott and James B. Zack

The CFPB’s Fall 2018 Rulemaking Agenda—
A Busy Schedule for 2019
Richard Horn

The Purpose and Design of the Community Reinvestment Act (CRA):
An Examination of the 1977 Hearings and Passage of the CRA
Josh Silver

What’s Old is New Again: The Future of Bank Partnership Programs
From Small Dollar Installment Loans to Mortgages to Everything
Catherine M. Brennan and Nora R. Udell

California Court of Appeal Finds that the FTC Holder Rule
Limits a Holder’s Liability for a Consumer’s Attorneys’ Fees
Scott J. Hyman and Tara Mohseni

Effective Revocation of Consent Under the
Telephone Consumer Protection Act Following
Reyes v. Lincoln Automotive Financial Services
Zachary D. Miller, Parris M. Bell, and Kathryn E. Grundy
CURRENT BANKING ISSUES IN THE CANNABIS INDUSTRY

Barry A. Abbott and James B. Zack

Barry A. Abbott is a shareholder at Lane Powell in Seattle, Washington, where he represents clients, including cannabis-industry participants, in all aspects of their corporate, financial services, internet, payments and e-commerce matters. He is nationally recognized for his experience developing ground-breaking consumer financial services products.

James B. Zack is an associate attorney at Lane Powell in Seattle, Washington, where he focuses his practice on creditors' rights, financial institutions, and emerging issues in cannabis law.

I. INTRODUCTION

Under the Controlled Substances Act ("CSA"),\(^1\) it is a federal crime to possess, sell, or manufacture marijuana, or to aid or abet others in doing so.\(^2\) Notwithstanding the CSA's broad prohibitions, thirty-three states, the District of Columbia, Guam, and Puerto Rico have enacted laws legalizing medical marijuana, and ten states have enacted laws legalizing recreational marijuana.\(^3\) Additionally, some Native American tribes have legalized marijuana, and others are exploring doing so.\(^4\)

The economic effect of these state-level legalization efforts is significant. The state-legal marijuana market is expected to exceed $23 billion by 2022.\(^5\)

---

As a result, the marijuana industry may generate over 467,000 full-time equivalent jobs by 2022.⁶

As more states explore legalization, and those states that have already legalized marijuana continue to fine-tune their regulatory frameworks, the growth of the marijuana industry is quickly evolving into a national phenomenon. Despite such wide growth, federal prohibition looms as the primary obstacle to developing uniform industry practices across the nation, most notably in the realm of banking.⁷

A. The Rescission of Helpful Guidance.

On August 29, 2013, Deputy Attorney General James M. Cole issued the so-called “Cole Memo,” providing “Guidance Regarding Marijuana Enforcement” to all U.S. Attorneys in response to state-law initiatives seeking to legalize and regulate marijuana possession, production, processing, and sale.⁸ The Cole Memo instructed U.S. Attorneys to use their discretion and generally defer to state law enforcement to enforce their own state’s laws and regulations, limiting their focus to eight enforcement priorities:

1. Preventing the distribution of marijuana to minors;
2. Preventing marijuana revenue from going to criminal enterprises;
3. Preventing the diversion of marijuana from states where it is legal under state law to other states;
4. Preventing use of legal marijuana as a pretext for trafficking other illegal drugs or activity;
5. Preventing violence or the use of firearms in connection with marijuana collection or distribution;
6. Preventing drugged driving or other public health issues;
7. Preventing marijuana growth on public lands; and
8. Preventing marijuana possession on federal property.⁹

Unfortunately, the Cole Memo’s helpful guidance was formally rescinded on January 4, 2018, by Attorney General Jefferson B. Sessions, III.¹⁰ The so-called “Sessions Memo” caused virtually all national financial in-

---

6. Id.
stitutions to refuse to engage with any marijuana-related businesses, even as those institutions were already reluctant to engage with marijuana-related businesses while the Cole Memo was in effect.

B. Some Helpful Guidance Continues.

On February 14, 2014, the Financial Crimes Enforcement Network ("FinCEN") issued its own guidance regarding marijuana-related businesses, referencing the Cole Memo.\footnote{11} FinCEN’s guidance modified (but did not eliminate) a financial institution’s obligation to file Suspicious Activity Reports ("SARs") for every marijuana business.\footnote{12} With marijuana businesses remaining illegal under federal law, SARs are still required. However, FinCEN’s guidance established three subsets of SARs for marijuana-businesses: "Marijuana Limited," "Marijuana Priority" and "Marijuana Termination."\footnote{13} Importantly, and even after the Sessions Memo rescinded the Cole Memo, FinCEN indicated that it will continue adhering to its guidance regarding marijuana-specific SARs.\footnote{14}

Financial institutions, along with all other trades and businesses, also remain subject to the general rules requiring Cash Transaction Reports (IRS Form 8300) to be filed for all cash transactions of more than $10,000.\footnote{15}

C. Federal and State Tax Laws.

Marijuana businesses are likely to suffer adverse tax consequences due to marijuana’s status under the CSA. Most significantly, federal tax law prohibits ordinary business expense deductions (including employee salaries) for businesses “trafficking” in “controlled substances” including marijuana.\footnote{16} Adverse tax rules may apply at the state level as well, although it is expected that states will adjust their tax laws to accommodate legal marijuana. For example, in Washington State, where medical marijuana is legal, a Department of Revenue holding that medical marijuana did not qualify for the State’s sales tax exemption for prescription drugs prompted the State legislature to create a new sales tax exemption specific to medical marijuana.\footnote{17}

II. FUTURE OUTLOOK

A high level of uncertainty exists regarding the legality of marijuana business. In June 2018, President Trump suggested continuation of the status quo and states’ rights; however, in August 2018, he created a Mari-
juana Policy Coordination Committee tasked with devising ways to turn public opinion against marijuana consumption and disparaging state laws legalizing marijuana. Attorney General Sessions, who recently resigned, had a well-documented history of advocating against marijuana legalization, and his resignation was understandably met with a surge in marijuana-business stock prices. It is unclear whether Attorney General William Barr will ultimately be a proponent of or deterrent to state and federal legalization efforts. At his confirmation hearing, Attorney General Barr’s position on marijuana enforcement covered a wide spectrum, indicating a personal preference for uniform nationwide prohibition, or in the alternative, reforming federal law to accommodate a state legalization framework rather than declining to enforce existing federal law prohibiting marijuana. For the time being, however, Attorney General Barr does not intend to target businesses that are in compliance with the Cole Memo.

Despite this federal uncertainty, state legalization efforts continue to spread. Marijuana legalization initiatives are becoming more common on state ballots, and polls suggest that a significant percentage of the country supports legalization, with 63% supporting recreational legalization and 93% supporting medical legalization.

There are also positive signs for legalization at the federal level. Most significantly, the recently-passed Agricultural Improvement Act of 2018 (Pub. L. 115-334) (“Farm Act”) decriminalized hemp growth and processing. While high cannabidiol (CBD) hemp is different from high tetrahydrocannabinol (THC) marijuana, the Farm Act illustrates the legislature’s willingness to rely on scientific analysis of the subject rather than reaching hasty, emotionally charged conclusions. Likewise, in June, the Federal Drug

22. Id.
24. Legalized “hemp” is defined as cannabis sativa with THC concentrations of “not more than 0.3 percent on a dry weight basis.” Agriculture Improvement Act of 2018, Pub. L. No. 115-334, H.R. 2, 115th Cong.
Administration approved a CBD-based pharmaceutical, Epidiolex, designed to suppress epilepsy seizures. Following these recent developments regarding the federal status of CBD and CBD-based pharmaceuticals, ongoing research of medical marijuana, both domestically and internationally, is increasing the likelihood of federal acceptance.

Federal tax reform also remains a possibility. As states continue to legalize medical and recreational marijuana, and adjust their own tax laws accordingly, the federal government may be inclined to relax the broad prohibition against marijuana businesses’ expense deductions to accommodate those businesses that are legal under applicable state law.

There is also an ongoing effort to federally recognize state legalization. The Strengthening the Tenth Amendment Through Entrusting States (STATES) Act would affirmatively grant each state the right to determine for itself the best approach to marijuana regulation and enforcement within its borders. Despite bipartisan support in the Senate and House of Representatives, support from many state governors, and outward approval from President Trump, the STATES Act directly contradicts the anti-marijuana purpose of President Trump’s Marijuana Policy Coordination Committee and has yet to receive a formal vote in Congress. Its provisions were not included in the Farm Act enacted in December of 2018. However, the STATES Act is expected to be back in play when the 116th Congress convenes in January 2019.

A. Current Bank and Non-Bank Activity.

Due to the current federal regulatory and enforcement climate, financial institutions (especially large, national institutions) generally refuse to engage with marijuana-related businesses, with regard to both deposit bank-

25. FDA News Release, FDA Approves First Drug Compromised of an Active Ingredient Derived From Marijuana to Treat Rare, Severe Forms of Epilepsy, (Jun. 25, 2018), https://www.fda.gov/newsevents/newsroom/pressannouncements/ucm611046.html.
ing and extending credit. Meanwhile, some smaller financial institutions (especially credit unions) allow marijuana-related businesses to maintain deposit accounts, while the void in the credit market is attracting non-bank entities (known as "financiers" under Washington State law). It is possible that this will change in connection with hemp production and products legalized by the Farm Act.

In July 2018, a Canadian medical marijuana company, Tilray, Inc., became the first marijuana company to complete an IPO on a major United States stock exchange, the Nasdaq.\textsuperscript{31} Two other Canadian companies that are publicly traded in Canada now trade in the United States as well, Cronos Group on Nasdaq and Canopy Growth on the New York Stock Exchange.\textsuperscript{32}

Specialized businesses are also proliferating to service marijuana businesses' banking needs. These include PayQwick and Tokken, which specialize in providing electronic payment services to marijuana customers and businesses.\textsuperscript{33} Entrepreneurs are constantly trying to develop techniques to facilitate commercial payments throughout the marijuana-related businesses, many of which incorporate cryptocurrency into marijuana-related transactions.\textsuperscript{34} Without such electronic payment services or traditional deposit banking services, marijuana businesses that are legal under state law must hold (and make all payments with) large amounts of cash. This leads to significant public safety concerns and extensive security expenses. Without government action to facilitate deposit banking and electronic transactions for state-legal marijuana businesses, the private sector is charged with solving the public safety concerns inherent to this high-revenue all-cash industry.

B. Challenges for Increasing Bank Activity.

The STATES Act and similar federal efforts to facilitate state-legal marijuana businesses suggest that legal means of marijuana business banking may be on the horizon. In the current climate, however, it is important that financial institutions remember that marijuana growers, processors, and retailers are engaged in activity that is prohibited under federal law, and that it is illegal to aid or abet such businesses.

"Know your customer" rules and guidelines that focus on identifying, evaluating, and monitoring banking clients for illegal activity are especially important when engaging with marijuana customers. Financial institutions are required to understand their customers' sources of funds, which may in turn require those financial institutions to vet their customers' customers to ensure funds are not sourced from illegal activity.

\textsuperscript{32} Id.
\textsuperscript{34} Id.
The federal Anti-Proliferation Act makes it unlawful to control any place “for the purpose of unlawfully manufacturing, storing, distributing or using a controlled substance” and real property linked to such unlawful activities is subject to forfeiture.\textsuperscript{35} Moreover, real property leases and mortgages are also problematic in the current federal regulatory environment. Such leases and mortgages often prohibit, or allow termination for, illegal activity on the subject property, and contain representations and covenants that the tenant or borrower is in (and will remain in) compliance with law. Presumably, a marijuana business would be in default under such a lease or mortgage from the time the documents are signed, creating an ever-present risk of eviction or foreclosure.

In addition to legal risk, there is a reputational risk for financial institutions that engage with marijuana businesses that are currently prohibited under federal law. Those concerns may extend to engaging with marijuana-related businesses and industries, such as retailers that sell paraphernalia that may be used for marijuana as well as non-marijuana products (such as tobacco), or businesses that provide services to marijuana businesses, such as security, architecture and engineering, lighting, or fertilizer. While these businesses may not be directly “trafficking” in marijuana, their close proximity suggests there may be heightened risks in accepting cash deposits or extending credit to any such marijuana-related businesses.

Furthermore, even if a financial institution were to extend credit to a marijuana business, foreclosing on marijuana-related collateral would likely raise significant practical issues. Marijuana businesses typically have no accounts because of the cash nature of their business, and inventory is restricted from sale under state law without a proper license (which a creditor is unlikely to have).\textsuperscript{36} Foreclosing on real property housing a marijuana grow operation, processor, or retail outlet could raise many of the same issues. Finally, because it remains a crime under federal law to possess or use marijuana, federal bankruptcy is not an option for the reorganization or liquidation of most failing marijuana businesses.\textsuperscript{37}

### III. Conclusion

While the Farm Act opens new avenues to financial institutions to take deposits and lend money to legal “hemp” producers and sellers, there is significant legal risk in the event any producers produce such products that exceed a 0.3-percent THC level. However, despite the risks for bankers, the environment concerning marijuana is clearly changing and the opportunities for potential business in the area make it important to stay closely abreast of future developments in the area.

\textsuperscript{36} While UCC § 9-408 allows a secured party to take and perfect a security interest in a license notwithstanding state law to the contrary, it does not allow the secured party to either use the license itself or to sell it to others.