



Emerging Issue

Top 5 FAQs Regarding Cannabis Financing

The cannabis industry is expected to more than double over the next five years as more states legalize marijuana and pressure mounts to decriminalize at the federal level. However, companies in the cannabis space (MRBs) face evolving laws that make it challenging to access banking and credit services, while banks and others seeking to help finance them must navigate unprecedented legal pitfalls.

Congress is grappling with ways to address competing calls, and the social issues that attend cannabis financing and profitability add a layer of complexity to rulemaking, requiring the coordination of the U.S. Treasury, the Food and Drug Administration (FDA) and the Alcohol and Tobacco Tax and Trade Bureau (TTB).

Davis+Gilbert Insolvency + Finance attorneys [Joseph Cioffi](#), [Christine DeVito](#), [Joel Melendez](#), [Anna Pinna](#), and [Nicole Serratore](#) answer the frequently asked questions regarding providing credit to MRBs. If you have any additional questions, please contact any of the authors or the Davis+Gilbert attorney with whom you have regular contact.

What Banks and Other Lenders Can Do Now

- When it comes to credit availability in the cannabis industry, there is potential for demand to outpace supply, unless lenders understand and accept that there are particular legal challenges.
- Know bankruptcy is not an option for MRBs so structure deals with an understanding of state law debt enforcement alternatives and understand potential risks with assignments or change in control potentially triggered by foreclosure activities.
- Anticipate significant due diligence on potential borrowers and ongoing monitoring once they become a customer.
- Understand regulatory risks and prepare for increased regulatory obligations and attendant costs.



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1. Q: Is it legal to loan money to a company in the cannabis industry?

- A. Generally, obtaining conventional funding is challenging. Due to the continued listing of marijuana as a Schedule I substance under the Controlled Substances Act (CSA), all financial proceeds related to marijuana are considered unlawful under federal law. The effect is financial institutions subject to the Bank Secrecy Act must monitor, scrutinize and report on funds derived from these activities as if they are unlawful.

In the limited field of cannabis financing, regional banks and credit unions or state-chartered institutions have been more active in lending, but they also may limit the types of lending they do with MRBs (e.g. real estate-backed loans only). Alternatively, they may lend but with caution based on the considerations below as well as guidance from state banking regulators.

2. Q: What does the current regulatory landscape look like?

- A. Marijuana is currently defined as having no accepted medical use and a high potential for abuse or misuse. The CSA prohibits the manufacture, distribution, dispensation or possession of marijuana.

Varying levels of legalization at the state level:

- Medical marijuana is now legal in 36 states.
- Recreational marijuana has been legalized in 17 states and Washington D.C.
- Some states, including North Carolina and Nebraska, have decriminalized marijuana.
- Illinois is the first state to legalize recreational marijuana sales through successful state legislation versus a voter referendum, Vermont was second, and New York is third.
- Cities may put restrictions on where dispensaries can be located. Some cities have even banned dispensaries outright.

3. Q: What are the regulatory hurdles and challenges for providing financing?

- A. Even though MRBs may be conducting legal activity at the state level, because all proceeds related to marijuana are considered unlawful under federal law, financial

institutions must monitor, scrutinize and report on funds derived from these activities as if they are unlawful.

However, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) has provided guidance for how financial institutions can work with state-authorized MRBs, but the result is still challenging.

Financial institutions subject to the Bank Secrecy Act (BSA) must review MRBs as part of their customer due diligence with the risk assessment required under their anti-money laundering obligations plus additional monitoring and scrutiny related to law enforcement concerns with respect to their cannabis business. Even if an MRB is legally operating within state law, financial institutions are expected to file Suspicious Activity Reports (SARs) for all MRB transactions and give consideration to the law enforcement priorities related to MRBs laid out by the Department of Justice.

Legislative efforts to try to reconcile the tension between federal and state law have thus far failed. There are bills pending that attempt to address some of these issues, but the political divide over these issues remains strong.

4. Q: **Are there limitations on lender remedies and enforcement of rights?**

- A. For most MRBs, bankruptcy is not currently an option due marijuana being a Schedule I Controlled Substance. Creditors of distressed MRBs can turn to state law alternatives to enforce their rights, including receiverships and assignments for the benefit of creditors. New York law poses some particular challenges in collection and foreclosure:
- For example, New York law requires a license to acquire, possess, distribute and sell marijuana, and it is possible that a receiver or assignee may need the proper licensing to be able to sell the business or cannabis assets.
 - Moreover, the New York Cannabis Control Board must approve changes of ownership, control or location in a company's license, which could further slow enforcement.

Finally, certain provisions in lending agreements can constitute violations of federal law, which can pose a challenge to lenders seeking to reduce their claims against a defaulted MRB to judgment. For example, at least one court has found

in *Bart St. III v. ACC Enters, Ltd. Liab.Co.*, that a “right of first refusal” provision permitting lenders to obtain stock in MRBs illegal because it enabled lenders to profit from marijuana sales in violation of the CSA.

5. Q: Are there special considerations MRBs must address as borrowers?

A. For banking and lending:

- Traditional offerings from national banks and financial institutions will continue to be off-limits as long as non-hemp cannabis remains a Schedule I drug under federal law.
- Many in the industry have turned to private investors and regional banks and credit unions for debt financing and traditional banking services.
- While lender profiles can vary greatly, many are private investors or state-chartered banking institutions (for debt financing relating to Medicinal Use and hemp companies in particular) who offer cannabis-related financial products only to in-state businesses.
- Obtaining financing and other financial accommodations from these lenders is not without its own challenges.
 - Expect to pay a premium.
 - Expect heavy due diligence.
 - Know what aspects of your business and risk factors could impact a lenders’ analysis.
 - Have a clear plan for profitability and understand the company’s potential stumbling blocks.

For compliance:

- Consider both federal and state law registration and/or notice requirements.
- Which regulatory bodies need to be notified and what needs to be disclosed is a fact intensive decision.
- Regardless of the type of funding, work with a lender that can assure 100% compliance in this rapidly growing and changing industry.

For More Information

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