



## BANKING AND CANNABIS WEBINAR

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The following pages are the introductory comments for Banking & Cannabis: Lending, the Next Frontier from BMD Banking and Cannabis Partner [Stephen Lenn](#).

### A. Introduction

1. Welcome attendees to this webinar focused on bank lending to the cannabis industry and a distinguished group of panelists drawn from each constituency: bank and cannabis regulators, bankers, and cannabis industry titans.
2. Later in this introduction I am going to explain some of the other the rationales for choosing this topic, but the response reflects that the choice was timely and a good one. At the same time, we are both pleased and flattered and disappointed that it was necessary to close registration last week when we hit our maximum capacity of 500 registrants. Eyeballing the list, it appears that we have about 350-400 bankers, representing between 200-250 geographically dispersed financial institutions. Registrants include at least a dozen of the 56 largest banks in the U.S., including 2 of the top 10 and a number whose assets are measured in the tens of billions
3. After a few more preliminaries and introducing our Panelists and Sponsors, I will kick off the webinar with some introductory remarks, following which Tanner Daniel, the American Bankers Association VP of Congressional Relations will offer a keynote on the status and prospects for the SAFE Act and other relevant pending federal legislation. We will then turn to our panelists for their views and a lively discussion. If there's time, we will respond to questions from the audience. If not, we will attempt to do so directly afterward.
4. Without going into detail, the cannabis industry is likely the fastest growing in the US. Revenues in 2021 are projected to be increase to about \$25 billion, representing a 25% increase over 2020. With states like NY legalizing rec, and additional states coming on stream, continuing dramatic growth seems assured

As the registration materials reflect, a motivating factor for undertaking this webinar is the huge opportunity bank lending represents for both industries: banks need good loans, and cannabis companies, which are become increasingly bankable, need lower borrowing costs. While rates on some recent non-bank loans have dipped below 10%, most loans outstanding and being made are priced in the mid-teens. According to Viridian Capital Advisors September 3, 2021, Cannabis Deal Tracker report, thus far this year debt transactions have totaled more than \$3 billion. On top of this, there are tens of billions of outstanding cannabis industry debt, some of which, likely substantial, could be refinance candidates.

5. Disclaimers and Caveats, and what would a lawyer do without them:

- a. First let me underscore that I do not identify as a cannabis lawyer; but rather as a corporate merger and acquisition, corporate finance and banking lawyer who was a top 100 bank general counsel and high-level bank regulatory lawyer with large national and regional firms who happens to have been involved in about \$2 billion of cannabis M&A and debt finance transactions. Most of the representations have been large public and private acquirors and institutional or quasi-institutional lenders but have also included borrowers and acquirees. As a result, I speak both banker and weed.
  - b. Second, as they may also indicate, our panelists are here in their personal capacities and the views expressed here are not necessarily the official positions of their organizations.
  - c. Third, everything we talk about is predicated on the absence of significant adverse medical, scientific, or social developments, none of which have yet surfaced. By way of comment, I am not aware of a single viable repeal effort
6. Sponsors, critical support staff and Panelists
- a. Before introducing our panelists, thanks to Paul Hickman of the Arizona Bankers Association, Jen Waller of the Colorado Bankers Association, Howard Headlee of the Utah Bankers Association, and Mike Adelman, of the Ohio Bankers League, for their co-sponsorship and assistance in recruiting the panel and structuring the program, and the American Bankers Association for making Tanner Daniel, its VP for Congressional Relations, available to give a keynote address updating us on the status and prospects for pending federal legislation.
  - b. Also, special thanks to Jennifer Shankleton, BMD's marketing director, and Madeline Lange, our marketing specialist, who did all the hard work behind the scenes that made this possible.
  - c. Panelists
    - i. Our bank panelists are Ashley Burt, CEO of Colorado's Gunnison Bank and Trust Company, and Frank Smith, VP of Operations of Phoenix based Republic Bank. Ashley has been serving the cannabis industry for many years and as CEO, the buck stops with him when it comes to business development, compliance, and regulatory relationships. Frank has now been involved in the initiation of cannabis business at two banks, in each case working with his board and regulators to develop, implement and oversee policies and procedures and continuing regulatory interface
    - ii. Representing the perspective of bank regulators, we are fortunate to have Kevin Allard, Ohio Superintendent of Banks, and Shane Foster, Arizona Deputy Superintendent of Banks. Ideally, we would have liked federal regulators to participate on the panel, but we were unable to persuade any to do

so, and it's not for lack of trying. Both Kevin and Shane regulate and examine banks providing services to the cannabis industry, often working with one or more federal bank regulators, so they can address the subject as they see it in real time, if and how the pending federal legislation might affect their approach and, perhaps, help us gain insights with respect to how the feds approach this.

- iii. The cannabis industry panelists are two Arizona homegrown industry superstars, each with multistate chops. Steve White is a founder and CEO of Harvest Health & Recreation, one of the largest public cannabis companies, which recently announced a multi-billion merger. Mark Steinmetz has been awarded licenses and overseen profitable operations in multiple states, some of which have been folded into one of the larger private multistate companies.

Both Steve and Mark are past presidents of the AZ Dispensary Owners Association.

- iv. Finally, to address the implications for bank lending of cannabis regulation, we have Greg McIlvaine, who was appointed Senior Policy Advisor to the Ohio Department of Commerce to oversee its licensing and regulation of cannabis activities other than retail, caregivers, and patients, including cultivation and processing, and Will Humble, who was Director of the Arizona Department of Health Services as its cannabis policies were being developed.

7. First, let's deal with the elephant in the room. Cannabis is still against federal law, and no one can provide assurance that there are no risks, however theoretical they might be. Anyone considering participating in cannabis related activities must make their own risk assessment. We can say, however, that these risks are mitigated by a number of factors:

- a. Federal enforcement policy has been largely hands off at both the DOJ and bank regulatory agencies.
  - i. While Attorney General Jeff Sessions officially rescinded the Cole Memorandum issued in 2013 by Deputy Attorney James Cole, which provided guidance to US Attorneys establishing a low enforcement priority for state legal activities that didn't involve one of the "deadly sins" identified in the Memorandum, there has been no perceptible change in that policy. Prosecutions and seizures of assets of compliant cannabis businesses are almost non-existent.
  - ii. Since 2014 there has been a continuing amendment to the federal budget which precludes the DOJ from using any appropriated funds to prosecute state compliant medical marijuana activities.
  - iii. There is formal federal recognition that financial services can be provided without violating the Bank Secrecy Act or anti money laundering laws which

has been used as a road map by those banks that are doing so and their regulators. In 2014, the Financial Crimes Enforcement Network (“FinCEN”), the division of the US Treasury Department charged with enforcing the anti-money laundering laws, issued guidance which stated its purpose as clarifying *“how financial institutions can provide services to marijuana-related businesses consistent with their BSA obligations....”* It further articulated that the Guidance was intended to *“enhance the availability of services for, and the financial transparency of, marijuana related businesses.”* The Guidance and an article summarizing it, *The Inevitable Inexorable Intersection; Banking and Cannabis*, are available through the program materials link.

- iv. Substantiation of the federal regulators’ hands off approach can be found in a June 2020 speech by FDIC Chair, Jelena McWilliams, in which she stated:

We know we have banks that are banking marijuana businesses, and you know, we can’t bless them and say “go ahead and do it.” But to the extent you’re doing it because it’s legal in your state, follow FinCEN guidance.

- v. Some comfort, as well as a competitive incentive for the banks, can be drawn from the Credit Union sector. As many of you know, Credit Unions are active in serving the cannabis business, and their regulators have been both more progressive and aggressive. Notwithstanding whatever internecine rivalry exists, their efforts are complementary, and worth noting. In a speech on September 9, NCUA Board member Rodney Hood, its former Chair, expressed his concern “that the legal and regulatory infrastructure surrounding the cannabis industry is not evolving quickly enough.”

While not endorsing any specific piece of legislation, he stated: “let me be clear about where I stand: it is time for federal action to clarify and harmonize the laws and regulations surrounding the state-legal cannabis industry and marijuana-related businesses (MRB), so that this industry can take part in the legitimate financial services industry.

He noted as a basic reality that “as a rule, regulators really don’t like to get out too far ahead of the policy process. We always seek to respect the existing statutes, and to defer to Congress as the policy-making arm of the government.

**However, there are times when a regulator in the executive branch needs to step forward to provide leadership, or at least nudge things along, when the policy process isn’t working as it should. I believe that’s the case today with marijuana and the financial services industry.**

**The bottom line is this: Legalization is going to happen, and the abdication of responsibility to address these issues in Washington is**

**simply ludicrous. This is precisely the time we need leadership at the federal level to steer this ship in the right direction.**

- b. The passage of the SAFE Act by the House, which doesn't legalize cannabis, but provides safe harbors for financial institutions, or one of the other pieces of pending federal legislation: The Cannabis Administration and Opportunity Act and the MORE Act each of which, among other things, would remove cannabis from the schedule of illegal drugs, and HR 365, which would move marijuana from Schedule I to Schedule III. The voters in more than 70% of the states have spoken, a percentage which mirrors public opinion, and I suspect even our most recalcitrant congressmen and senators will eventually do the math.
- c. The pain points of the current circumstances will also be drivers. Examples include:
  - i. the IRS and state and local tax authorities, many of whom are pushing for legislation addressing the banking issue because they are not set up for cash payments
  - ii. as noted in a recent CNBC interview, Boris Jordan, CEO of Curaleaf, one of the largest public cannabis companies, focused on the impact of these circumstances on the more than 300,000 (and rapidly growing) cannabis industry employees
  - iii. the impact on the banking relationships of the growing number of MRBs
- 8. The catalyst for the webinar was an article I wrote in February focusing on bank lending to the cannabis industry, a copy of which is available through the link provided to registrants for program materials. That article was the most recent in a series of 50,000-foot articles reporting on and anticipating the evolution of the cannabis industry. All included references to the banking situation and reflect two recurrent themes: "Out of the shadows and into the mainstream," and Woodward and Bernstein's mantra in *All the President's Men*, "Follow the money." I believe both the sponsorships and registration for this webinar are illustrative of the efficacy of those themes. Query- 5 years ago would our sponsors have been receptive to a webinar like this and would we have attracted as many registrants?
- 9. The catalysts for the article were;
  - a. the passage by the House of SAFE Act by substantial, bi-partisan majority, and the introduction of the other bills that would change the landscape
  - b. the magnitude of the opportunity presented by convergence of interests between the banking and cannabis industries, which present each with potential financial benefits measured in the tens and perhaps hundreds of billions.

- c. the likelihood that processes and protocols re deposit activities were probably largely in place and would not be materially changed by any new legislation, and that progress on access to payment systems was more remote, making lending next on the horizon
  - d. my view that, while the passage of the SAFE Act, or any of the other pending federal legislation, would greatly accelerate bank lending, it seems anywhere between likely and certain that those activities will continue to increase whether or not any of the proposed legislation passes
10. While the exact number of banks currently serving the cannabis industry is hard to pin down, it is certainly a very, very small percentage of all banks, mostly community banks providing deposit accounts. Reports that the number of insured institutions serving the cannabis industry is approaching 800 are based on Suspicious Activity Report filings and are probably significantly overstated.

Spoiler alert to banks that have thus far not determined to take the plunge, including the larger banks, this show is coming to a theater near you. I believe Ashley has a perspective on the bigger banks approach. The message to those banks is you can run but you can't hide.

First, as the cannabis industry continues its rapid growth, an increasing number of good existing or prospective bank customers will become engaged in financial and business relationships with cannabis businesses, almost certainly triggering cannabis banking issues. This trend is described in the Inevitable Intersection article that is available through the program materials link.

Second, some of the largest companies in the world are itching to find enough wiggle room to acquire cannabis assets. When, not if, but when, they do, are banks going to toss out companies like Altria and Constellation Brands? In this connection, I am intrigued by the language in Section 3 of the SAFE Act as passed by the House. It provides

“For purposes of ... (this act), **and all other provisions of Federal law**, the proceeds from a transaction involving activities of a cannabis related legitimate business or service provider shall not be considers proceeds from an unlawful activity solely because (it involves certain activities legitimate cannabis related activities specified in the Act) ....”

As an aside, smaller banks shouldn't be scared off by the prospect of larger institutions entering the fray. First, those banks have survived, and indeed thrived, in the face of industry consolidation, and they will likely also do so in serving the cannabis industry. Second, there is an analog to my experience in my practice. I staked out a position relatively early on. When I started in the practice in 2015 there were virtually no larger law firms that would. Now, most major firms have entered the practice, some aggressively (follow the money), and even though I am not

practicing at one of those firms, as a by-product of staking out a position early, and positioning myself to compete as the market evolved, I still have a ticket to the dance and a seat at the table. So can banks that get in early and do it well.

11. Banks that are serving the cannabis industry have developed protocols and practices based on the FinCEN Guidance (which has not amended since issued in 2014). In applying the Guidance, it is important to note
  - a. The Guidance articulates its
    - i. objective of clarifying “*how financial institutions can provide services to marijuana-related businesses consistent with their BSA obligations....*”
    - ii. intent to “*enhance the availability of services for, and the financial transparency of, marijuana related businesses.*”
  - b. Unfortunately, the Guidance did not define the term “marijuana related business (“MRB”), although a footnote suggests that a relationship as remote as being a landlord could result classification as an MRB. The SBA has tried its hand, but its efforts have shed little light. The SBA’s attempt is also noted in the Inevitable Intersection article.
  - c. The Guidance adopts as underlying precepts the priorities established pursuant to the Cole Memorandum, enumerating what I call the deadly sins:
    - Preventing distribution to minors;
    - Preventing revenue from the sale of marijuana from going to criminal enterprises;
    - Preventing the diversion of marijuana to states in which it is not legal;
    - Preventing state authorized marijuana activities from being used as a cover for other; drug trafficking or illegal activity;
    - Preventing the use of firearms in the cultivation and distribution of marijuana;
    - Preventing drugged driving and other adverse health consequences.
12. In essence, the Guidance calls for know your customer due diligence on steroids but adopts a risk-based approach which has been applied by the banks serving the cannabis industry, and banking regulators, to require more due diligence the closer a customer is to the plant and the greater the potential of facilitating one or more of the deadly sins. While I’ll let our bank and bank regulatory panelists go into detail if they wish, virtually all policies segment that risk into tiers, tier one requiring the highest level, and often limit the relationships to non-plant touching customers in lower tiers.
13. A key question for banks and their regulators will be whether lending implicates different bank regulatory considerations beyond the normal financial and credit analyses of any borrower. The protocols and processes established for deposit

relationships may require at least tweaking, perhaps more, of existing protocols – holding a customer’s money is one thing, lending that money is another.

14. This brings us to the rationale for adding cannabis regulators to our panel. From the perspective of a corporate finance and banking lawyer, when I first began my work in the cannabis industry in 2015, I was struck by the extent to which cannabis laws and regulations did not reflect a recognition that the industry required lots of capital and that capital has a cost. As a result, documenting capital formation and debt financing frequently requires complicated workarounds, which could be an impediment to conventional bank financing.
15. Cannabis regulation is also quite new in most states, and laws, regulations and regulators have focused primarily on licensing and compliance. As the industry evolves, so to must the regulatory frameworks. Banking regulation has evolved to the point that bank regulators, in addition to their compliance responsibilities, recognize that their regulatory objectives are also served when banks are profitable and financially solid. As the bankers know, after federal exams each bank is given a composite rating called a CAMELS rating—capital, assets, management, earnings, liquidity and sensitivity—which in some sense controls what banks may do. Hopefully, as the cannabis industry and its regulation matures, cannabis regulators will expand their horizons to reflect a recognition that compliance is enhanced by financial stability and success. The cooperation of cannabis regulators to facilitate access to banking services, including lower borrowing costs, will likewise enhance both their ability to oversee the industry and the ability, capacity, and incentives of their regulated businesses to comply.
16. Examples of potential areas cooperation could include both substantive modifications, such as pathways to security interests in licenses, and some which, at least on their face, are more mechanical, such as the issuance directly to lenders, perhaps at the request of license holders, of “good standing certificates” confirming that the underlying licenses were validly issued and are in good standing.

In our prep session, I asked the bankers what cannabis regulatory changes they’d like to see. Ashley gave a flippant “Nothing.” Since I suspect that his motivation was not entirely altruistic, I’m giving him and the bank regulators a heads up; I’m going to restate the question: What cannabis regulatory changes would facilitate bank lending?

17. Lastly, and gratuitously, an aside to the cannabis industry regarding interstate operations that are currently prohibited. The banking industry may provide some insight. When I first entered the banking world in 1975 interstate banking was prohibited. Then, during the 1980s, the industry saw the establishment of interstate compacts that provided reciprocity—you can buy a bank in my state if banks from my state can buy banks in yours. Ultimately, in 1994, interstate banking was approved. Not sayin, just sayin.

Thanks for your attention and now before engaging the other panelists, let's hear from Tanner on the federal legislation.