The Collision of Healthcare, Banking and Marijuana

Council of State Governments
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J. Kevin A. McKechnie
Executive Director, ABA HSA Council
Article VI: This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.
The Faithful Execution Clause

Article II: “he shall take care that the laws be faithfully executed…”
The Controlled Substances Act (CSA)
- 21 U.S. Code starting at section 801
- Passed by Congress and signed by President Richard Nixon in 1970
- The CSA is Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970.
- Under the statute, the manufacture, importation, possession, use and distribution of certain substances is regulated.

- Marijuana, along with LSD and Heroin, is classified under Schedule I, the most restrictive part of the statute
- According to the DEA, Schedule I drugs are considered the most dangerous class of drugs with a high potential for abuse and potentially severe psychological and/or physical dependence
# Federal Penalties

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
<th>1st Offense</th>
<th>2nd Offense</th>
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<tbody>
<tr>
<td>Marijuana</td>
<td>1,000 kg or more mixture; or 1,000 or more plants.</td>
<td>- Not less than 10 years, Not more than life.</td>
<td>- Not less than 20 years, Not more than life.</td>
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<td>- If death or serious injury, Not less than 20 years, Not more than life.</td>
<td>- If death or serious injury, Not more than life.</td>
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<td>- Fine not more than $4 million individual, $10 million other than individual.</td>
<td>- Fine not more than $8 million individual, $20 million other than individual.</td>
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<td>Marijuana</td>
<td>2,000 kg to 999 kg mixture; or 100,000 to 999,999 plants.</td>
<td>- Not less than 5 years, Not more than 40 years.</td>
<td>- Not less than 10 years, Not more than life.</td>
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<td>- If death or serious injury, Not less than 20 years, Not more than life.</td>
<td>- If death or serious injury, Not more than life.</td>
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<td>- Fine not more than $2 million individual, $5 million other than individual.</td>
<td>- Fine not more than $4 million individual, $10 million other than individual.</td>
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<tr>
<td>Marijuana</td>
<td>50 to 99 kg mixture; or 50 to 99 plants.</td>
<td>- Not less than 20 years.</td>
<td>- Not more than 30 years.</td>
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<td></td>
<td></td>
<td>- If death or serious injury, Not less than 20 years, Not more than life.</td>
<td>- If death or serious injury, Not more than life.</td>
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<td>- Fine $1 million individual, $5 million other than individual.</td>
<td>- Fine $2 million individual, $10 million other than individual.</td>
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<tr>
<td>Marijuana</td>
<td>Less than 50 kg mixture</td>
<td>- Not more than 5 years.</td>
<td>- Not more than 10 years.</td>
</tr>
<tr>
<td>Hashish Oil</td>
<td>10 kg or more</td>
<td>- Fine not more than $250,000, $4 million other than individual.</td>
<td>- Fine $500,000 individual, $2 million other than individual.</td>
</tr>
<tr>
<td>Hashish Oil</td>
<td>1 kg or more</td>
<td></td>
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</tbody>
</table>
State Legalization Laws

Timeline of State Marijuana Legalization Laws

2000 - 2001: Montana, Vermont, Rhode Island
2006 - 2007: West Virginia, Arkansas, Florida, North Dakota, Ohio, Pennsylvania, California, Maine, Massachusetts, Nevada

Source: AlibertArianFuture.com
State Legalization Laws

Marijuana Legalization by State

Key Statistics

59.3% of the U.S. population now lives in a state where marijuana has been legalized

- 29 states plus Washington DC have medical marijuana laws...
- 19 states plus Washington DC have operating dispensaries
- 8 states plus Washington DC have recreational marijuana laws...
- 4 with operating retail stores

Source: Marijuana Business Daily, U.S. Census Bureau
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Source: AlibertArianFuture.com
State Law Landscape

• A state “legalizing” cannabis does not mean its legal; it remains a Schedule 1 substance and carries stiff penalties for possessing it.

• It means only that the state’s political leadership, mostly directed by referendum, has decided to allocate law enforcement and prosecutorial resources to other crimes.

• It is also an inherent challenge to the federal government and congress; States retreating from enforcing federal drug laws by definition invite the federal government to do it themselves or make a change.
Federal Accommodation of State Law

The Obama Administration

• Justice Department Memos

• Treasury Department (FinCEN) Guidance
The Department of Justice

- Since federal and state laws are in conflict, the Department of Justice has issued four successive memos for U.S. attorneys.
  - October 19, 2009
  - June 29, 2011
  - August 29, 2013
  - February 14, 2014
- The memos offer guidelines for federal prosecutors who have “discretion” when investigating and prosecuting cases
- Originally, the guidelines addressed states that had “legalized” the use of marijuana for medical purposes
- More recently, the guidelines encompass jurisdictions that permit recreational use under state law
The first guideline was the “Ogden Memo” issued by Deputy Attorney General David Ogden. “The guidelines make clear that the focus of federal resources should not be on individuals whose actions are in compliance with existing state laws, while underscoring that the Department will continue to prosecute people whose claims of compliance with state and local law conceal operations inconsistent with the terms, conditions, or purposes of those laws.”

AG Eric Holder stated, “It will not be a priority to use federal resources to prosecute patients with serious illnesses or their caregivers….”
Key Points from the Ogden Memo:

- Uniform guidance instead of state-by-state guidelines
- Emphasizes DOJ is committed to the enforcement of the Controlled Substances Act
- At the same time, the Department is committed to efficient and rational use of its limited investigative and prosecutorial resources – prosecutors should not focus resources on individuals “whose actions are in clear and unambiguous compliance with existing state laws”
- The focus is not users or their caregivers but distributors and suppliers; HOWEVER, “…no State can authorize violations of federal law…”
The first memo from Deputy AG James Cole
Focused on “commercial cultivation and distribution of marijuana purportedly for medical use”
Again underscores DOJ commitment to enforcing the Controlled Substances Act
While the memo emphasizes that the DOJ view has not changed, the tone of the memo places greater emphasis on prosecution of illegal drug use as the core priority for DOJ:
“The Ogden Memorandum was never intended to shield [large scale cultivation] from federal enforcement action and prosecution, even where those activities purport to comply with state law.”
August 29, 2013, DOJ issued a third memo

While this memo was intended to update DOJ federal marijuana enforcement policy in light of recent state initiatives, “…the Department makes clear that marijuana remains an illegal drug under the Controlled Substances Act and that federal prosecutors will continue to aggressively enforce this statute”

However, it goes on to point out that, “the federal government has traditionally relied on state and local authorities to address marijuana activity through enforcement of their own narcotics laws”
The DOJ “8” – August 29, 2013

The memo expands and clearly explains the eight factors DOJ will use to focus its activities (resources):

1. Prevent sale and distribution to minors
2. Prevent revenue from reaching criminal enterprises
3. Prevent diversion of marijuana from states where it is legal to states where it is not
4. Prevent state-authorized marijuana activity from being used to cover trafficking in other illegal drugs or other illegal activity
5. Prevent violence and the use of firearms in cultivation and distribution
6. Prevent drugged driving and other “adverse public health consequences”
7. Prevent public lands from being used to grow marijuana
8. Prevent marijuana use on federal property
The memo places new emphasis on the state regulatory system as a factor to consider:

- “...prosecutors should continue to review marijuana cases on a case-by-case basis and weigh all available information and evidence, including, but not limited to, whether the operation is demonstrably in compliance with a strong and effective state regulatory system.”

The DOJ again points out, as it had done previously, that it is not likely an effective use of prosecutorial resources to focus on seriously ill individuals or their caregivers.

Finally, the memo stresses that, “As with the Department’s previous statements on this subject, this memorandum is intended solely as a guide to the exercise of investigative and prosecutorial discretion.”
• Restated many of the priorities of the August 2013 guidance, including the 8 factors

• Addressed financial crimes for the first time: “The provisions of the money laundering statutes, the unlicensed money remitter statute, and the Bank Secrecy Act (BSA) remain in effect with respect to marijuana-related conduct. Financial transactions involving proceeds generated by marijuana-related conduct can form the basis for prosecution…”
• “…financial institutions that conduct transactions with money generated by marijuana-related conduct could face criminal liability under the BSA…”
• “…if the financial institution or individual is willfully blind to such activity by, for example, failing to conduct appropriate due diligence of the customers’ activities, such prosecution might be appropriate.”
• “…if the financial institution or individual offers services to a marijuana-related business whose activities do not implicate any of the eight priority factors, prosecution for these offenses may not be appropriate.”
• “…it is essential that financial institutions adhere to FinCEN’s guidance.”
Health Savings Accounts (HSAs)
HSA Value Proposition: 401(k)s for Health

• Triple Tax Advantaged Vehicle – better than 401(k)
  1. Contributions are Deductible
  2. Account Balances Grow Un-taxed
  3. Health Care Distributions are Tax Free

• 2017 Contribution Maximum
  – Individual $3,400
  – Family $6,750
The Coming HSA Wave

• Nearly 43% of Non-elderly Americans already in an HDHP

• Of those, approximately 40% have an HSA

• More than 50% of the working population will be enrolled in HSAs by 2020.
The Coming HSA Wave

Total HSA Assets (in billions)

Source: Devenir Research
The Coming HSA Wave

Total HSA Accounts

Source: Devenir Research
The Coming HSA Wave

HSA Investment Assets (in billions)


Assets: $0.1, $0.2, $0.2, $0.4, $0.9, $1.1, $1.7, $2.3, $3.2, $4.2, $5.5, $7.3, $9.4, $11.9

% HSA Assets in Investments:
- 2006: 7%
- 2007: 5%
- 2008: 4%
- 2009: 5%
- 2010: 7%
- 2011: 8%
- 2012: 11%
- 2013: 12%
- 2014: 13%
- 2015: 14%
- 2016: 15%
- 2017 (est): 16%
- 2018 (est): 17%
- 2019 (est): 19%

Source: Devenir Research
Requirements for an HSA

- Be covered by an HSA-qualified high deductible health plan (HDHP)
- Have no other coverage that is not “high-deductible coverage”
  - This includes Medicare, Medicaid, Tricare, health care flexible spending accounts (FSAs), etc.
- Not be claimed as a dependent on someone’s tax return (i.e., minor children cannot have their own HSA)
Requirements for an HSA-Qualified HDHP

• Minimum deductible
  – 2017: $1,300 (single coverage) / $2,600 (family coverage)
  – 2018: $1,350 (single coverage) - $2,700 (family coverage)

• The deductible must apply to all covered benefits from in-network providers
  – the only exception is “preventive care”
HSAs & Medical Marijuana

What are HSA-qualified Medical Expenses and is Cannabis one of them?
HSAs & Medical Marijuana

NO!

And Here’s Why
It's a felony.
HSAs & Medical Marijuana

• Illegal for any licensed physician to prescribe Schedule I substances

• Doctors can write “Recommendations” for medical cannabis but some state laws restrict the conditions for which even a recommendation can be accommodated
HSAs & Medical Marijuana

- **IRS Publication 502:**

  “You can't include in medical expenses amounts you pay for controlled substances (such as marijuana, laetrile, etc.) that aren't legal under federal law, even if such substances are legalized by state law.”
HSAs & Medical Marijuana

• Credit Card Companies will not offer services to Cannabis businesses
• No “cannabis” Merchant Category Code (MCC)
• No Authorizing Banks
• So Cash is King
FinCEN Guidance


- “The guidance provides that financial institutions can provide services to marijuana-related businesses in a manner consistent with their obligations to know their customers and to report possible criminal activity.”

- “Law enforcement will now have greater insight into marijuana business activity generally, and will be able to focus on activity the presents high-priority concerns.”
FinCEN Expectations

• “In general, the decision to open, close or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution.”

• “Thorough customer due diligence is a critical aspect of making this assessment.”
FinCEN Expectations

• Customer due diligence should include:
  – Verifying with state authorities that the business is duly licensed and registered
  – Reviewing the license application and related documentation
  – Requesting available information about the business and related parties from state licensing and enforcement authorities
  – Developing an understanding of the normal and expected activity for the business, including types of product to be sold and customers to be served
  – Ongoing monitoring of public sources for possible adverse information about the business and related parties
  – Refreshing information about the business on a periodic basis
FinCEN Expectations

• “As part of its customer due diligence, a financial institution should consider whether a marijuana-related business implicates one of the Cole Memo priorities or violates state law. This is a particularly important factor for a financial institution to consider when assessing the risk of providing financial services to a marijuana-related business.”
Suspicious Activity Reporting (SAR)

• The guidance goes on to remind banks that state law does not change a financial institution’s obligation to file a SAR
  “Because federal law prohibits the distribution and sale of marijuana, financial transactions involving a marijuana-related business would generally involve funds derived from illegal activity.”
• SARs are required when the information is useful to law enforcement – FinCEN intends the guidance to help financial institutions determine how to file a SAR
Suspicious Activity Reporting

• **Marijuana Limited SAR**
  – Filed when the business does not violate one of the 8 priorities in the Cole memo or state law
  – Provides the following information:
    • Identification of the subject and related parties
    • Address of the subject and related parties
    • The fact that the filing is being made only because the subject is a marijuana business
    • The fact that no other suspicious activity has been detected
  – The term MARIJUANA LIMITED should be used in the narrative of the SAR
Suspicious Activity Reporting

• **Marijuana Priority SAR**
  – If the financial institution suspects that one of the Cole memo priorities has been implicated or that state law has been violated, it should file a Marijuana Priority SAR
  – Details particularly relevant for a Marijuana Priority SAR:
    • Identifying information of the subject and related parties
    • Addresses of the subject and related parties
    • Details regarding the enforcement priorities involved
    • Dates, amounts & other relevant details of financial transactions involved in the potentially suspicious activity
  – The term MARIJUANA PRIORITY should be used in the narrative section of the SAR
Suspicious Activity Reporting

- **Marijuana Termination SAR**
  - If a financial institution decides to terminate the relationship with the marijuana-related business “to maintain an effective anti-money laundering compliance program,” it should also file a SAR
  - The narrative section should explain why the relationship was terminated – “It’s a Felony” perfectly acceptable answer
  - If a financial institution believes the relationship is moving to another financial institution, FinCEN urges the first institution to use the 314(b) process to put the second institution on notice
Suspicious Activity Reporting

• **Red Flags to Distinguish Priority SARs**
  – The business serves as a front to launder money from other criminal activity
  – The business cannot produce appropriate documentation that it is operating in accordance with state law
  – The business cannot demonstrate the legitimate source of outside investments
  – A customer seeks to disguise a relationship with a marijuana-related business
  – Public sources reveal negative information about the business or its principles
  – A marijuana-business engages in interstate or international transactions
  – The owners of the business reside in another state
  – Proximity of the business to a school is not consistent with state law restrictions
The Senate Reacts

• April 2, 2014, Senators Chuck Grassley (R-IA) and Dianne Feinstein (D-CA) wrote to Director Calvery about the guidance, stating that it “is dangerously misleading”

• The Senators went on to point out that, “following the guidance may expose financial institutions to civil or criminal liability” and that “until federal law is changed, selling marijuana, laundering marijuana proceeds, and aiding and abetting those activities all remain illegal.”

• The letter suggests the guidance “turns FinCEN’s mission on its head.”
The letter raised a series of questions for FinCEN to answer about the guidance, including:

- What is the legal authority for the guidance?
- Does the guidance alter federal law?
- Does the guidance affect BSA criminal penalties?
- Does FinCEN have enforcement discretion?
- Will FinCEN take steps to protect financial institutions that follow the guidance?
Non-Compliance Grows Like Weeds

• Lending Risks
  – Lending on illegal collateral is prohibited
    • No inventory or receivables secured loans
  – Lending on marijuana related real estate is problematic
    • For example: shoppettes with a marijuana dispensary tenant, single family homes with grow operations, warehouses with grow operations, misc. properties with grow operations
    • Property is subject to federal seizure
    • The property may not be insurable
    • Income from marijuana tenants – should it be counted towards debt service?
    • Overall, it is very risky to lend into properties that have a marijuana business
You Can’t Un-See It

– Existing loans
  • When a marijuana tenant is discovered
    – Should the loan be called?
    – Can the loan be called (sufficient default provisions in the note)?
    – Should the loan be allowed to continue to maturity?
    – What happens at maturity?

– Loan documentation
  • Borrowers should certify that no marijuana tenants will be accepted
  • Default language should be added to address marijuana tenants
Edge of Tomorrow

Four Conclusions:

1. While several states have legalized marijuana for medical (and recreational) use, marijuana is still a “controlled substance” federally, and thus, is illegal

2. Banks are caught in the middle of the conflict and efforts to help have not been effective (DOJ and FinCEN guidance)

3. Banks should decide now if and how they will or will not bank marijuana business; and, finally

4. What is prudent practice today, may be obsolete tomorrow
Resources and Materials
ABA Resources:


DOJ Memoranda (reverse chronological order):


Other Government-Related Materials:


Other Government-Related Materials (continued):


• U.S. H.R. 83 the “Consolidated and Further Continuing Appropriations Act, 2015” or CRomnibus (Dec. 16, 2014, Public Law No. 113-235) – accessible [https://www.congress.gov/113/bills/hr83/BILLS-113hr83enr.pdf](https://www.congress.gov/113/bills/hr83/BILLS-113hr83enr.pdf)
