

WHITE PAPER

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MARIJUANA LEGALIZATION IN VERMONT: IMPLICATIONS FOR  
FINANCIAL SERVICES

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DECEMBER 17, 2015



## Introduction

Marijuana legalization is a complex issue that is being debated across the United States. Although marijuana is illegal under federal law and listed as a schedule I drug,<sup>1</sup> many states are exploring ways to legalize or decriminalize marijuana. Twenty-three states, including Vermont, have laws that permit medical marijuana use.<sup>2</sup> Vermont, like several other states, has decriminalized possession of a small amount of marijuana.<sup>3</sup> Additionally, four states and the District of Columbia have recently passed laws that allow recreational use and a for-profit commercial marijuana industry.<sup>4</sup>

Vermont, like several other states, is considering the legalization of marijuana and weighing implications. A comprehensive report that outlines the potential consequences of legalizing marijuana in Vermont was released in early 2015 (“RAND report”).<sup>5</sup> The RAND report is the result of a legislative directive to the Secretary of Administration to analyze taxation and regulation of marijuana in Vermont.<sup>6</sup> Following the release of the report, public debate about legalization of marijuana has picked up,<sup>7</sup> and a bill was introduced in the state Senate during the 2015 legislative session that would create a system for taxation and regulation of recreational marijuana.<sup>8</sup> The Vermont Senate Government Operations Committee met outside of the legislative session in 2015 to discuss how legal marijuana should be regulated in the state, and produced a draft bill to be introduced during the 2016 legislative session.<sup>9</sup>

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<sup>1</sup> 21 U.S.C. §§ 802(6), 812, 841(a)(1).

<sup>2</sup> Julie Hill, *Banks, Marijuana, and Federalism*, 65 Case Western L. Rev. 598 (2015); 18 V.S.A. § 4474b.

<sup>3</sup> See Act 76 of 2013 (amending 18 V.S.A. § 4230 to replace criminal penalties with civil penalties for possession of an ounce or less of marijuana or five grams or less of hashish by a person 21 years of age or older); Devin Kelly, *Marijuana decriminalization bill signed into law in Vermont*, L.A. Times (June 7, 2013), <http://articles.latimes.com/2013/jun/07/nation/la-na-nn-vermont-marijuana-decriminalization-20130607> (noting that Vermont was the 17<sup>th</sup> state to adopt legislation decriminalizing possession of small amounts of marijuana).

<sup>4</sup> Hill, *supra* note 2, at 599.

<sup>5</sup> Jonathan P. Caulkins *et al.*, RAND Corporation, *CONSIDERING MARIJUANA LEGALIZATION: INSIGHTS FOR VERMONT AND OTHER JURISDICTIONS* (2015).

<sup>6</sup> Act 155 of 2014, § 8a.

<sup>7</sup> See, e.g., Terri Hallenbeck, *Legal Pot in Vermont? Not Yet, Say Some Top Policy Makers*, SEVEN DAYS, Jan. 21, 2015, <http://www.sevendaysvt.com/vermont/legal-pot-in-vermont-not-yet-say-some-top-policy-makers/Content?oid=2507551> (discussing effort to legalize marijuana in Vermont); Dan D’Ambrosio, *Vermont looks West while pondering legal pot*, BURLINGTON FREE PRESS, Jan. 30, 2015, <http://www.burlingtonfreepress.com/story/news/politics/2015/01/30/vermont-weighs-marijuana-legalization/22596807/> (discussing Vermont legalization efforts and lessons learned from Colorado and Washington); Brent Curtis, *Legalizing Marijuana: Colo. Teaches Vermont to go slowly*, TIMES ARGUS, Feb. 15, 2015, <http://www.timesargus.com/article/20150215/THISJUSTIN/702159924> (discussing findings of Vermont delegation that visited Colorado to learn about recreational marijuana industry); Matt Ferner, *Vermont Could Be The Next State To Legalize Recreational Marijuana*, HUFFINGTON POST, Feb. 17, 2015, [http://www.huffingtonpost.com/2015/02/17/vermont-marijuana-legalization\\_n\\_6662426.html](http://www.huffingtonpost.com/2015/02/17/vermont-marijuana-legalization_n_6662426.html) (discussing bill introduced in Vermont Senate that would legalize recreational marijuana).

<sup>8</sup> S.95 of 2015, *An act relating to regulation and taxation of marijuana*.

<sup>9</sup> Terri Hallenbeck, *Lawmakers Ponder How, Not Whether, to Legalize Marijuana*, SEVEN DAYS, Nov. 3, 2015, <http://www.sevendaysvt.com/OffMessage/archives/2015/11/03/lawmakers-ponder-how-not-whether-to-legalize-marijuana>, Terri Hallenbeck, *Senator Unveils Vermont Marijuana Legalization Bill*, SEVEN DAYS, Dec. 14, 2015, <http://www.sevendaysvt.com/OffMessage/archives/2015/12/14/senator-unveils-vermont-marijuana-legalization-bill>.

Legalizing marijuana in Vermont would have a variety of consequences, some of which involve the financial services industry. The Department of Financial Regulation (“DFR”) prepared this paper to outline ways that marijuana legalization and financial services intersect, and to highlight some potential issues that could arise if Vermont changes its marijuana laws. While there are many topics to consider when discussing marijuana legalization, this report aims only to highlight the most pressing issues relevant to the financial services sector.

This report is organized into four sections. The first section discusses the relationship between marijuana legalization and banking. The second section discusses the same with respect to securities, and the third section discusses the same with respect to insurance. The fourth section provides some examples of the Vermont experience so far. Within each section, observations and questions for policymakers to consider will be introduced.

## **Section I: Marijuana and Financial Institutions**

Lack of access to basic banking services is a significant and well-documented problem for marijuana-related entities, even in states that have legalized marijuana. Nationally, most financial institutions refuse to accept deposits from marijuana businesses or offer other account services, which means that marijuana businesses are forced to operate on a cash-only basis.<sup>10</sup> An abundance of cash creates an easy target for theft, and requires marijuana businesses to make significant investments in cash management and security measures such as vaults, security guards, and armored cars.<sup>11</sup> Bills, taxes, and employees often have to be paid in cash, presenting practical difficulties for marijuana businesses.<sup>12</sup> The banking issue raises regulatory concerns because the risks of illegal diversion and non-payment of taxes are increased, and harder to detect and track, on a cash-only basis.<sup>13</sup> Additionally, financial institutions are largely unwilling to lend money to marijuana businesses, resulting in a lack of access to capital.<sup>14</sup>

The reluctance from financial institutions is based on marijuana’s illegality on the federal level and status as a schedule I drug under the Controlled Substances Act (“CSA”). Individuals and businesses that violate the CSA are subject to prosecution under federal law. Financial

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<sup>10</sup> Hill, *supra* note 2, at 600-601; Serge Kovaleski, *Banks Say No to Marijuana Money, Legal or Not*, N.Y. TIMES, Jan. 11, 2014, <http://www.nytimes.com/2014/01/12/us/banks-say-no-to-marijuana-money-legal-or-not.html>; Jacob Sullum, *Marijuana Money Is Still A Pot Of Trouble For Banks*, FORBES, Sept. 18, 2014, <http://www.wsj.com/articles/SB10001424052702304049904579515911975177756>; Jeffrey Stinson, *States Find You Can’t Take Legal Marijuana Money to the Bank*, PEW TRUSTS, Jan. 5, 2015, <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/1/5/states-find-you-cant-take-legal-marijuana-money-to-the-bank>.

<sup>11</sup> See, e.g., Dennis Webb, *Lack of banking plagues pot shops*, THE GRAND JUNCTION DAILY SENTINEL, Dec. 8, 2015, <http://www.gjsentinel.com/news/articles/lack-of-banking-plagues-pot-shops> (discussing an armed robbery at a marijuana shop and the need for banking options).

<sup>12</sup> Payment of taxes with cash can present a real problem for marijuana businesses, as tax authorities generally prefer or require payment by methods other than cash. For instance, federal tax law requires that employee withholding taxes be paid electronically. The IRS recently penalized a Denver medical facility for paying by cash rather than electronically, and the IRS did not consider inability to obtain a bank account cause to abate the penalty. That penalty is now being challenged in a U.S. tax court. David Migoya, *IRS to bankless Colorado dispensary contesting fines: Too bad*, DENVER POST, Feb. 16, 2015, [http://www.denverpost.com/business/ci\\_27537093/irs-bankless-colorado-dispensary-contesting-fines-too-bad?source=infinite](http://www.denverpost.com/business/ci_27537093/irs-bankless-colorado-dispensary-contesting-fines-too-bad?source=infinite).

<sup>13</sup> Sam Kamin, *The Limits of Marijuana Legalization in the States*, 99 IOWA L. REV. BULL. 39, 47 (2014).

<sup>14</sup> Hill, *supra* note 2, at 601.

institutions that deal with marijuana businesses could risk violation of the CSA. For instance, provision of banking services could be considered aiding and abetting the distribution of marijuana, conspiring to distribute marijuana, or acting as an accessory after the fact.<sup>15</sup> Even if banks were not directly at risk of prosecution under the CSA (for example, due to a policy of prosecutorial discretion), banks could still be wary of providing loans to marijuana businesses because the assets of a marijuana business are subject to forfeiture under the CSA.<sup>16</sup> Further, federal anti-money laundering statutes (such as the Money Laundering Control Act, Bank Secrecy Act (“BSA”), and Patriot Act) present additional risks for financial institutions considering marijuana banking. A financial institution could commit money laundering by conducting financial transactions related to specified illegal activity or criminally derived property.<sup>17</sup> Anti-money laundering statutes also impose requirements on banks to maintain programs designed to detect and prevent money laundering. Financial institutions are required to identify suspicious transactions and report illegal and suspicious activity to the federal Financial Crimes Enforcement Network (“FinCEN”).<sup>18</sup>

Given these risks, financial institutions have shown an unwillingness to do business with marijuana-related entities under current federal law. In response, the U.S. Department of Justice (“DOJ”) and FinCEN each released guidance regarding marijuana-related business and financial crimes on February 14, 2014.<sup>19</sup> The guidance outlines ways that a financial institution could provide services to marijuana businesses consistent with BSA obligations and eight marijuana-related CSA enforcement priorities outlined in an earlier DOJ guidance. The guidance requires that financial institutions implement anti-money laundering controls and conduct rigorous due diligence on marijuana customers to ensure they are following state law and DOJ guidance. In addition, the FinCEN guidance establishes categories of marijuana-related suspicious activity reports that financial institutions must file.

The federal guidance documents do not amend existing federal laws or grant immunity to financial institutions that engage in marijuana banking. Instead, the documents outline expectations for financial institutions that want to provide services to marijuana businesses, and direct prosecutors to prioritize cases where institutions fail to adhere to the guidance. The guidelines have not put financial institutions at ease, and most institutions remain reluctant to deal with marijuana businesses absent a change in federal law because financial institutions that

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<sup>15</sup> Hill, *supra* note 2, at 607-608.

<sup>16</sup> Erwin Chemerinsky *et al.*, *Cooperative Federalism and Marijuana Regulation*, 62 UCLA L. REV. 74, 93 (2015).

<sup>17</sup> Hill, *supra* note 2, at 607-608. The “‘manufacture, importation, sale, or distribution of a controlled substance,’ including marijuana, is a ‘specified unlawful activity’ under the money laundering statute.” *Id.*

<sup>18</sup> *Id.* at 610-17.

<sup>19</sup> Dep’t of the Treasury, Fin. Crimes Enforcement Network, Guidance: BSA Expectations Regarding Marijuana-Related Businesses, FIN-2014-G001 (Feb. 14, 2014), *available at* [http://www.fincen.gov/statutes\\_regs/guidance/pdf/FIN-2014-G001.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf); Memorandum from James M. Cole, Deputy Attorney Gen., to United States Attorneys (Feb. 14, 2014), *available at* <http://www.justice.gov/usao/waw/press/newsblog%20pdfs/DAG%20Memo%20-%20Guidance%20Regarding%20Marijuana%20Related%20Financial%20Crimes%202%2014%2014%20%282%29.pdf>.

serve marijuana businesses could potentially face the loss of a charter, reputational risk, and violation of laws like the CSA or BSA.<sup>20</sup>

In places where marijuana is legal, either recreationally or medically, lack of access to financial services remains a significant problem that some states are working to resolve. Colorado passed a law in June 2014 that would allow the marijuana industry to form “cannabis credit co-ops,” designed to function as financial services institutions similar to credit unions.<sup>21</sup> The cooperatives may serve only certain marijuana businesses, are limited in number to 10, and are prohibited from being labeled as a credit union or bank. The intent of the legislation was to alleviate the problem of having cash-only marijuana businesses.<sup>22</sup> However, no cooperatives have been pursued under the new law.<sup>23</sup> The lack of success of the cooperative law to date may be the result of a requirement in the law that cooperatives obtain Federal Reserve approval before commencing operations or conducting business in order to get a state charter.<sup>24</sup> Critics of the law find it unlikely that the Federal Reserve would approve an institution that deals with a drug that is illegal at the federal level, thus making it unlikely a state charter could be issued.<sup>25</sup>

One Colorado group has taken another approach and formed a credit union under Colorado’s existing credit union laws. The Fourth Corner Credit Union (“Fourth Corner”), which would serve the marijuana industry, received a charter from Colorado in November 2014.<sup>26</sup> However, the state license was granted with the condition that Fourth Corner still obtain approval from the Federal Reserve before opening for business. Fourth Corner applied with the Federal Reserve for a master account, and with the NCUA for credit union deposit insurance. Colorado law allows a credit union to operate under state charter while an application for share-deposit insurance is pending.<sup>27</sup> Colorado law also allows a credit union operating under state charter to petition for approval to utilize private insurance in the event that the NCUA denies an application.<sup>28</sup> Thus, so long as Fourth Corner obtained a master account, it would be possible to obtain private insurance and open even without NCUA coverage. However, the Federal Reserve denied Fourth Corner’s

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<sup>20</sup> See, e.g., Sullum, *supra* note 9 (noting that the guidance documents provide “no promises” to banks, and reiterate reasons for prosecution); Stinson, *supra* note 9 (discussing the guidance documents and their failure to assuage concerns of bankers). Even beyond possible FinCEN or DOJ enforcement, other federal authorities such as the Federal Reserve, FDIC or NCUA could take action against financial institutions that serve marijuana businesses. Hill, *supra* note 2, at 617-30.

<sup>21</sup> Colorado H.B. 1398 of 2014, *available at* [http://www.leg.state.co.us/clics/clics2014a/csl.nsf/fsbillcont2/06F7F4159729909387257CCA0082B929/\\$FILE/1391\\_enr.pdf](http://www.leg.state.co.us/clics/clics2014a/csl.nsf/fsbillcont2/06F7F4159729909387257CCA0082B929/$FILE/1391_enr.pdf).

<sup>22</sup> See Colo. Rev. Stat. § 11-33-102 (stating legislative declaration).

<sup>23</sup> David Migoya, *Promise for pot-banking co-op sees little progress since it was law*, THE DENVER POST, Sept. 14, 2014, [http://www.denverpost.com/marijuana/ci\\_26525249/promise-pot-banking-co-op-sees-little-progress](http://www.denverpost.com/marijuana/ci_26525249/promise-pot-banking-co-op-sees-little-progress).

<sup>24</sup> Colo. Rev. Stat. § 11-33-104(4)(a).

<sup>25</sup> Migoya, *supra* note 21; Jack Healy, *Marijuana Trade Offered Credit Union Relief in Colorado*, N.Y. TIMES, May 8, 2014, [http://www.nytimes.com/2014/05/09/us/politics/marijuana-trade-offered-credit-relief-in-colorado.html?\\_r=0](http://www.nytimes.com/2014/05/09/us/politics/marijuana-trade-offered-credit-relief-in-colorado.html?_r=0).

<sup>26</sup> Matt Richtel, N.Y. TIMES, Feb. 5, 2015, <http://www.nytimes.com/2015/02/08/business/marijuana-industry-in-colorado-eager-for-its-own-bank-waits-on-the-fed.html>.

<sup>27</sup> David Migoya, *Fourth Corner pot credit union in Denver waits for federal master account*, THE DENVER POST, Dec. 11, 2014, [http://www.denverpost.com/business/ci\\_27116449/fourth-corner-pot-credit-union-denver-waits-federal](http://www.denverpost.com/business/ci_27116449/fourth-corner-pot-credit-union-denver-waits-federal).

<sup>28</sup> Colo. Rev. Stat. § 11-30-117.5.

application for an account in July, 2015.<sup>29</sup> That same month, the NCUA informed Fourth Corner that it was not eligible for credit union deposit insurance.<sup>30</sup> Fourth Corner responded by filing lawsuits in federal court against the Federal Reserve and the NCUA that challenge the denials.<sup>31</sup>

As it stands, both the cooperative and credit union options in Colorado were made contingent on Federal Reserve approval, and the experience in Colorado suggests that approval will not be granted to an institution that services the marijuana industry unless something changes in federal law or policy. Other states are discussing other potential avenues for providing financial services to the marijuana industry,<sup>32</sup> but none have taken action yet. On the federal level, a bipartisan bill was introduced in the U.S. Senate on March 10, 2015, that would reclassify marijuana to a Schedule II substance and allow medical use in states that have laws that permit medical marijuana.<sup>33</sup> Additionally, the bill would allow financial institutions to provide services to marijuana-related businesses that operate in accordance with state laws and creates a safe harbor to protect financial institutions from federal criminal prosecution or investigation for providing those services. Similarly, a bill was introduced in the House of Representatives on April 28, 2015, that would provide a safe harbor for depository institutions providing financial services to a marijuana-related legitimate business.<sup>34</sup> It is unclear whether either bill will gain traction, but they provide a good model of legislation at the federal level that could enable financial institutions to provide services to marijuana businesses with more comfort.

As Vermont considers the possibility of legalizing marijuana for recreational use, the availability of banking services for marijuana businesses should be examined. A lack of access to banking services is problematic for practical, regulatory, and security reasons. Under existing state and federal frameworks, Vermont financial institutions may choose to provide services to marijuana businesses following FinCEN and DOJ guidance. There is no guarantee that a sufficient number of financial institutions will do so, particularly absent a change in federal law. Vermont could explore alternative options for provision of banking services to the state marijuana industry, such as the marijuana cooperative legislation passed in Colorado. However, DFR believes that existing Vermont financial institutions could service a state-level recreational industry, and that examples of successful banking relationships already exist in the medical marijuana context. DFR's Banking Division could work with financial institutions that wish to provide services to marijuana businesses to make sure that best practices are followed and to develop compliance programs that ensure the institutions follow relevant state and federal rules and guidance.

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<sup>29</sup> Nathaniel Popper, *Banking for Pot Industry Hits a Roadblock*, N.Y. TIMES, July 30, 2015, <http://www.nytimes.com/2015/07/31/business/dealbook/federal-reserve-denies-credit-union-for-cannabis.html>.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*; see also Kirk Mitchell, *Federal Reserve says chartering pot bank is illegal, refuses to do so*, THE DENVER POST, Oct. 22, 2015, [http://www.denverpost.com/news/ci\\_29008607/federal-reserve-says-chartering-pot-bank-is-illegal](http://www.denverpost.com/news/ci_29008607/federal-reserve-says-chartering-pot-bank-is-illegal) (discussing the Federal Reserve's motion to dismiss the lawsuit).

<sup>32</sup> For instance, Alaska is discussing the possibility of creating a state-backed bank to serve the marijuana industry. Scott Woodham, *Does Alaska plan to create a state bank to handle cannabis business funds?*, ALASKA DISPATCH NEWS, Feb. 10, 2015, <http://www.adn.com/article/20150210/does-alaska-plan-create-state-bank-handle-cannabis-business-funds>.

<sup>33</sup> Compassionate Access, Research Expansion, and Respect States Act of 2015, S. 683 (as introduced).

<sup>34</sup> Marijuana Businesses Access to Banking Act of 2015, H.R. 2076 (as introduced).

## Section II: Marijuana and Securities

Marijuana-related investments are becoming increasingly common. Though most investments are still relatively modest,<sup>35</sup> private investment in the marijuana industry is growing. At this point, marijuana investments are still a relative novelty and institutional investors are slow to invest in marijuana.<sup>36</sup> Many existing marijuana investors are wealthy individuals, and larger investment firms may not invest until shares are listed publicly. Additionally, marijuana businesses report difficulty obtaining bank loans, as discussed in Section I, and investors may be reluctant to invest in businesses that do not have bank accounts. However, a recent investment of several million dollars by a Silicon Valley venture capital firm in a marijuana-focused private equity firm's \$75 million Series B fund-raising effort is being viewed as a "watershed moment" that could inspire more established investors to back marijuana businesses.<sup>37</sup> Some funds that are only open to wealthy, accredited investors and specialize in marijuana investments are also springing up.<sup>38</sup>

Marijuana stocks are traded on the public stock market, and a marijuana stock index exists that tracks the marijuana industry.<sup>39</sup> Most investments are made in companies that are peripheral to the marijuana industry, rather than companies that directly produce or process marijuana – such as consulting, real estate, producers of lighting and other growing supplies, security services, and biotechnology.<sup>40</sup> So far, all marijuana industry stocks are traded over-the-counter,<sup>41</sup> and FINRA and the SEC have put out alerts that discourage investment in marijuana-related businesses due to the potential for fraud.<sup>42</sup> The SEC alert also cautioned investors that "marijuana-related companies may be at risk of federal, and perhaps even state, criminal prosecution."<sup>43</sup> In late January 2015, the SEC allowed a share registration to proceed for a California company whose business model includes direct cultivation and sale of marijuana.<sup>44</sup> The SEC gave approval for the company's registration to go effective without affirmative action (the SEC declined to "accelerate" the registration, citing "policy" reasons, so there is a 20 day waiting

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<sup>35</sup> See Andrew Sorkin, *Ethical Questions of Investing in Pot*, N.Y. TIMES, Jan. 12, 2015, <http://dealbook.nytimes.com/2015/01/12/ethical-questions-of-investing-in-pot/> (noting that the legal marijuana industry raised \$104 million in 59 deals in 2014, and most deals were relatively small).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*; David Pierson, *Venture capital firm gives marijuana industry a shot of credibility*, L.A. TIMES, Jan. 8, 2015, <http://www.latimes.com/business/la-fi-founders-fund-marijuana-20150109-story.html>.

<sup>38</sup> Jane Hodges, *Buying Legalized-Marijuana Stocks: Just Say No?*, WALL STREET JOURNAL, June 8, 2015, at R1. These funds will not speak publicly, "for fear of violating accredited-investor solicitation rules and rules about marijuana." *Id.*

<sup>39</sup> MJIC Marijuana Index, <http://marijuanaindex.com/>.

<sup>40</sup> Carol Tice, *Meet The 8 Hottest Publicly Traded Marijuana Companies*, Forbes, Nov. 14, 2014, <http://www.forbes.com/sites/caroltice/2014/11/14/meet-the-8-hottest-publicly-traded-marijuana-companies/>.

<sup>41</sup> *Id.*

<sup>42</sup> See, e.g., SEC, Investor Alert: Marijuana-Related Investments, May 16, 2014, <http://investor.gov/news-alerts/investor-alerts/investor-alert-marijuana-related-investments> (noting temporary trading suspensions of five marijuana-related companies, and warning of fraud associated with marijuana-related investments).

<sup>43</sup> *Id.*

<sup>44</sup> Gregory Millman, *SEC Allows Pot Dealer to Register Stock Shares*, RISK & COMPLIANCE JOURNAL, <http://blogs.wsj.com/riskandcompliance/2015/01/28/sec-allows-pot-dealer-to-register-stock/>.

period until the registration is effective). Registration with the SEC opens the door for new financing opportunities for marijuana businesses.

In Vermont, investments related to marijuana businesses that are legal at the state level (whether medical or recreational) could be traded on an intrastate basis under the jurisdiction of DFR. Vermont does not have a prohibition against offering or selling securities related to marijuana, and could adopt a policy of allowing such registrations. It could even be possible for marijuana-related companies to raise capital utilizing state exemptions such as the Vermont Small Business Offering Exemption. If a marijuana business wanted to offer or sell a security that falls under federal jurisdiction, the ability to do so would depend on federal interpretation of securities laws. Based on the recent share registration approval by the SEC, it appears that legal marijuana businesses in Vermont would have the ability to trade on both an intrastate and interstate basis.

### **Section III: Marijuana and Insurance**

Marijuana legalization has interesting implications for the insurance industry. Legal marijuana business owners typically need or want to obtain insurance coverage for their businesses. However, marijuana businesses report difficulty obtaining coverage because standard insurance carriers generally will not cover them. Some reasons that insurers may be reluctant to cover marijuana businesses include marijuana's status as an illegal drug under federal law, potential reputational risk for insurers, and difficulty in evaluating risk due to the newness of the industry.<sup>45</sup>

As a result, marijuana businesses are often left with surplus lines coverage, which is typically more expensive than standard coverage. Marijuana businesses typically obtain general liability, property, and worker's compensation coverages, and may also need or want specialized coverages such as professional liability, product liability, auto liability for deliveries, or theft coverage. Some businesses may even be required to obtain certain coverages as a condition of financing or under state law. For instance, Washington requires marijuana licensees to obtain specific insurance coverages and to name the state Liquor Control Board as an additional insured on policies.<sup>46</sup> While marijuana businesses have found success in obtaining these coverages on the surplus lines market, that may soon be changing. Lloyd's of London provided a substantial share of the coverages available for marijuana operations. However, on May 29, 2015, Lloyd's distributed a memo to its United States syndicates that it will no longer support insuring marijuana operations of any kind until the drug is formally legalized at the federal level.<sup>47</sup> The memo instructs that any such existing policies should not be renewed, and no new business should be written. Coverage for marijuana businesses may now be harder to find as a result of Lloyd's exit from the marketplace given its share of the market, and other insurers may follow Lloyd's example.<sup>48</sup>

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<sup>45</sup> Heather Draper, *Marijuana businesses can get insurance, but it's pricey*, DENVER BUS. JOURNAL, Dec. 23, 2013.

<sup>46</sup> Wash. Admin. Code § 314-55-082.

<sup>47</sup> Amy O'Connor, *Lloyd's Stops Insuring Marijuana Firms Due to U.S. Law Conflicts*, INSURANCE JOURNAL, June 24, 2015.

<sup>48</sup> *Id.*



Aside from the issue of coverage availability for businesses, questions have been raised as to whether legal marijuana is covered under existing policies. Most existing standard policies are silent on marijuana, meaning that it is neither expressly included nor excluded from coverage.<sup>49</sup> Where a policy is silent, there is room to debate whether marijuana that is legal at the state level is covered. For example, marijuana could arguably be included in a standard homeowner's policy coverage of \$500 for trees, shrubs, or bushes. While this limit may be insufficient to cover the full value of marijuana plants, it could offer some protection against losses for home growers. Another example might be whether or not auto policies cover drivers that drive under the influence of marijuana. However, a tension between state and federal marijuana law exists where policies contain exclusions for things like "contraband" or "illegal activity." In a recent Hawaii case, a U.S. District Court held that an insured could not recover for theft of her medicinal marijuana plants because she had no insurance interest in the plants due to their illegality at the federal level (despite that medical marijuana is legal under Hawaii law, and her possession of the plants was legal under state law).<sup>50</sup> It seems likely that insurers will begin including express inclusions or exclusions for marijuana in new policies as more states legalize medical and recreational marijuana. In the meantime, however, questions may arise where there is silence or ambiguity in a policy regarding coverage in the context of marijuana possession or use that is legal at the state level.

In the health insurance context, medical marijuana is not covered and medical marijuana patients are left to cover costs out of pocket.<sup>51</sup> Marijuana's classification as a Schedule I drug means that there is no accepted medical use for the drug under federal law.<sup>52</sup> Some states have recognized this problem and offer discounts for low-income patients at state medical dispensaries, or reduced prices for registration with the state as a medical marijuana patient.<sup>53</sup> Until a change occurs at the federal level, it appears unlikely that health insurers will cover medical marijuana. If Vermont chose to legalize marijuana, DFR would take the position that insurers should cover losses of legal amounts of marijuana under relevant insurance policies unless a policy contains a specific exclusion. Insurers would be free to insert policy exclusions or limitations if they so choose. Vermont could also consider the option of following Washington's example by requiring marijuana businesses to obtain certain types and levels of coverage.

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<sup>49</sup> Brenda Wells, *Marijuana Legalization: Implications for Property/Casualty Insurance*, 37 J. OF INS. ISSUES 77 (2014).

<sup>50</sup> *Tracy v. USAA Cas. Ins. Co.*, 2012 WL 928186 (D. Haw. 2012).

<sup>51</sup> Michelle Andrews, *When Your State Says Yes To Medical Marijuana, But Your Insurer Says No*, NPR, Nov. 20, 2012, <http://www.npr.org/sections/health-shots/2012/11/20/165554172/when-your-state-says-yes-to-medical-marijuana-but-your-insurer-says-no>.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

## Section IV: The Vermont experience

Vermont has four medical marijuana dispensaries that operate under state law and are registered with the Department of Public Safety.<sup>54</sup> Each of the four dispensaries currently access services from a financial institution. DFR spoke with a dispensary and the financial institution that it banks with to provide insight into how the dispensaries currently access financial services and what obstacles exist.

### *Vermont Patients Alliance, Inc., Montpelier, Vermont*

DFR spoke with a Director of the Vermont Patients Alliance, Inc. (“VPA”). VPA shared that it initially struggled to find a solid banking relationship. VPA opened three successive financial accounts in its first year, only to have each one closed due to VPA’s status as a marijuana business. VPA found that local branches of financial institutions were generally supportive of marijuana businesses and willing to provide services, but that the parent companies of the local branches would require the local branches to stop providing services to VPA upon discovery that it is a dispensary. Eventually, the Vermont State Employees Credit Union (“VSECU”) approached VPA and offered to provide services. VPA presently holds an account with VSECU.

VPA is unable to process credit or debit card transactions, and currently operates on a cash or check only basis. VPA shared that having to deal primarily with cash not ideal for customers or for the dispensary.

Finding insurance coverage has been “extremely difficult” and expensive for VPA. The dispensary has general liability coverage, but has not obtained crop coverage or directors insurance. VPA was initially insured through Lloyd’s of London, but was reassigned to a new carrier this year by their local agent when Lloyd’s stopped providing services to marijuana businesses.

VPA also expressed that finding locations to lease is difficult, and that it is hard for them to obtain loans through traditional means.

### *Vermont State Employees Credit Union, Montpelier, Vermont*

DFR met with representatives from VSECU to discuss provision of depository services to marijuana businesses. VSECU currently provides services to one dispensary (discussed above), but feels that it has the capacity to serve many more marijuana-related businesses within its existing framework.

Prior to the issuance of Cole Memo and the 2014 DOJ and FinCEN guidance documents, VSECU did not provide services to any dispensaries or other marijuana businesses based on direction from the NCUA. Following the release of the guidance documents, VSECU developed internal policies and procedures that enable VSECU to provide services to marijuana-related businesses in a manner that is consistent with federal guidance.

VSECU has a questionnaire and due diligence checklist that it completed prior to opening an account for VPA and would complete for any additional marijuana businesses that seek to open an account with VSECU. The customer due diligence includes obtaining certifications from the businesses regarding the businesses’ compliance with the priorities

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<sup>54</sup> See 18 V.S.A. chapter 86 (Vermont’s laws on therapeutic use of cannabis).

identified in the Cole memo, a site visit to the business, and review of financial and other documents obtained from the business. VSECU conducts compliance follow ups every six months after a marijuana business opens an account. It also has a software system in place that monitors accounts for activity that would necessitate SAR filings. VSECU's compliance program for marijuana-related businesses has been reviewed by both federal and state regulators. Unlike other customer accounts held at VSECU, funds in accounts held by marijuana-related businesses are not insured by the NCUA. VSECU also shared that while it is comfortable with providing depository services to marijuana-related businesses, it would consider offering loans to the businesses, but would need to consider the risk presented by the collateral being at risk of seizure under the CSA.

### **Summary**

This paper raises regulatory issues that legalization could pose for the financial services industry. Legalization will impact Vermont's banking, securities, and insurance sectors and as such, DFR recommends that financial services be part of the legalization discussion.

## A D D E N D U M

January 20, 2016

Legal marijuana is a rapidly evolving industry with a changing regulatory and business landscape. This addendum provides updates and new information that DFR has learned after the initial release of the White Paper.

### *Securities: Fund Raising and Interstate Issues*

DFR believes that securities under the jurisdiction of DFR that are related to state-legal marijuana could be traded on an intrastate basis. Interstate sale of these securities would be on a state-by-state basis and would depend on a state's securities act and the discretion of the securities administrator. In some states, for instance, a state administrator might be able to reject an offering based on illegality at the federal level or within that state.<sup>55</sup>

State legal marijuana businesses that are raising capital need to comply with federal and state securities law. Marijuana investments can be ripe for fraud or a lack of understanding of regulatory requirements by marijuana businesses. For example, Colorado recently issued a cease and desist order against an individual that was soliciting unregistered investments for a marijuana business on Craigslist.<sup>56</sup>

Marijuana businesses may have the ability to crowdfund. Colorado, Washington, and Maine have each enacted laws designed to allow intrastate crowdfunding by marijuana businesses.<sup>57</sup> The ability to crowdfund on an interstate basis would depend on the factors discussed above, as well as any policies or restrictions that crowdfunding platforms or portals may have.

### *Financial Institution Insurance Coverage*

DFR has confirmed that both the FDIC and the NCUA would view funds held by a financial institution for a marijuana business as insured with the same limits and conditions that apply to any other business. DFR previously heard contradictory information on this topic, which is indicative of some confusion around this novel issue.

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<sup>55</sup> As an example, the DFR Commissioner "may" issue a stop order for a registration statement where it is in the public interest and one or more additional criteria are met, including if "the issuer's enterprise or method of business includes or would include activities that are unlawful where performed. 9 VSA § 5306(4). Arguably, if another state had this language (which is based on a model act), it could not deny a registration statement for a Vermont state-legal marijuana business under this provision because the activity would be lawful "where performed".

<sup>56</sup> Colorado Department of Regulatory Agencies, *Cease and desist issued to local marijuana business owner*, July 16, 2015, <https://www.colorado.gov/pacific/dora/news/cease-and-desist-order-issued-local-marijuana-business-owner>.

<sup>57</sup> Anne Wallace, *Equity Crowdfunding for Cannabis in Colorado*, MARIJUANA INVESTMENT NEWS, July 30, 2015, <http://mjnews.com/equity-crowdfunding-cannabis-colorado/>.

Additionally, DFR has learned of two examples in which the FDIC is working with banks located in Connecticut that have chosen to provide services to marijuana businesses to ensure that the banks are complying with federal guidance about marijuana banking. This suggests that Vermont financial institutions that are federally regulated could potentially serve marijuana businesses.

### *Colorado Court Case Update*

As discussed in Section I of the White Paper, the Fourth Corner Credit Union (“Fourth Corner”) is an institution formed under a Colorado law enacted to promote the creation of state-chartered financial institutions that serve marijuana businesses. Colorado’s law conditioned licensure of these institutions on approval by the Federal Reserve. Fourth Corner’s applications for a master account with the Federal Reserve and for deposit insurance through the NCUA were both denied. Fourth Corner challenged the denials in separate lawsuits filed in federal court. On January 5, 2016, a judge for the United States District Court for the District of Colorado dismissed Fourth Corner’s suit against the Federal Reserve, and stated that it could not use its powers to issue an order that would “facilitate criminal activity.”<sup>58</sup> The judge explained that marijuana remains illegal under federal law, and that the guidance documents issued to financial institutions by the Department of Justice and FinCEN only outline prosecutorial priorities. The judge called the marijuana banking situation “untenable,” and stressed the need for Congress to address the issue.<sup>59</sup> Fourth Corner’s suit against the NCUA is still pending, but it is likely to have a similar outcome.

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<sup>58</sup> David Migoya, *Judge tosses Denver marijuana credit union’s suit for federal approval*, DENVER POST, Jan. 5, 2016, [http://www.denverpost.com/news/ci\\_29347393/judge-tosses-denver-marijuana-credit-unions-suit-federal](http://www.denverpost.com/news/ci_29347393/judge-tosses-denver-marijuana-credit-unions-suit-federal)

<sup>59</sup> *Id.*