

# Challenges Faced by Cannabis Firms in Obtaining Financing through Traditional Banks

## Overview:

One of the critical components needed for businesses to be successful is access to capital. Cannabis businesses are no different, however, their access to traditional financing sources has been restricted. This paper examines the struggles faced by cannabis firms in securing financing through traditional banks and explores the reasons behind this phenomenon. Despite the growing acceptance and legalization of cannabis in many jurisdictions, cannabis businesses continue to encounter significant obstacles when



Photo: Karolina Grabowska/Pixels

seeking financial services from traditional banking institutions. Hurdles from regulatory and legal uncertainties, the federal prohibition of cannabis, and the associated risks are reasons that hinder banks from engaging with cannabis firms. However, the lack of traditional financing has opened alternative sources that have filled the void, providing the much-needed capital while simultaneously generating opportunities for investors.

## Introduction: The Evolution

Cannabis has experienced significant growth and increased medical and recreational acceptance in various regions globally. According to New Frontier Data, 70 countries have legalized cannabis for medicinal use and 10 have done so for adult use. While much can be written about the global landscape, the focus here is on the US, and even with this ever-increasing acceptance, cannabis firms often encounter significant hurdles when seeking financial support from traditional banks due to the complex legal and regulatory landscape. These are in stark contrast to non-cannabis-related businesses which often have greater success obtaining traditional financing.

## Regulatory and Legal Uncertainties: Why?

The primary obstacle faced by cannabis firms in securing financing from traditional banks lies in the regulatory and legal uncertainties surrounding the industry. While individual states and countries have legalized cannabis to varying degrees, it remains illegal at the federal level in many jurisdictions. The conflicting federal and state laws create ambiguity and complexity for financial institutions, leading to risk aversion when dealing with cannabis-related businesses. For example, under the administration of President Barack Obama, the Department of Justice (DoJ) issued guidance commonly referred to as the Cole Memorandum that instructed federal prosecutors to focus their enforcement efforts relating to marijuana on specific enforcement priorities, such as preventing the distribution of marijuana to minors and ensuring that revenues from the sale of marijuana did not flow to criminal enterprises, and ensuring that state-legal marijuana activity was not used as a cover for the trafficking of other illegal drugs.<sup>1</sup> This was a significant shift of government policy away from strict enforcement however the policy shift was dependent on any

change in administration. In 2018, then-Attorney General Jeff Sessions rescinded the Cole Memorandum creating further uncertainty.

As it stands, under federal law in the United States, cannabis is classified as a Schedule I controlled substance, which poses significant legal challenges for banks. Financial institutions must comply with federal regulations, such as the Bank Secrecy Act (BSA) and the Controlled Substances Act (CSA), which mandate reporting and monitoring requirements. Consequently, banks hesitate to engage with cannabis firms to avoid potential legal and regulatory repercussions, including money laundering charges and the risk of losing their federal banking licenses.

Traditional banks are inherently risk-averse due to their obligation to protect depositors' funds and maintain the financial system's stability. Engaging with cannabis firms exposes banks to various risks, including reputational, operational, and compliance risks. These risks arise from the stigma associated with cannabis, concerns about money laundering, difficulty in verifying the legality of funds, and challenges in assessing creditworthiness due to limited access to historical financial data. If a bank does venture into financial transactions with a cannabis firm, the BSA requires the filing of a Suspicious Activity Report (SAR). Failure to do so may result in costly penalties, serious fines, and for publicly traded banks, the risk of removal from listed exchanges.

#### **Alternative Financing Options:**

Recognizing the challenges faced by cannabis firms, alternative financing options have emerged to bridge the funding gap. These alternatives include specialized cannabis-focused real estate funds, private equity firms, crowdfunding platforms, private credit, and strategic partnerships. Although these alternative financing arrangements fill the void and can provide investors with the potential for outsized returns, they often carry higher financing costs than would otherwise be the case.

Today there are several potential solutions that would allow cannabis companies enhanced access to an expanded source of capital, such as legislative reforms, like federal descheduling or decriminalization of cannabis, which would allow financial institutions to operate in compliance with state laws without fear of federal penalties. Additionally, the implementation of robust regulatory frameworks, enhanced due diligence procedures, and guidance from regulatory agencies can provide clarity and reduce the risks associated with banking cannabis firms.

#### **Conclusion:**

The struggles faced by cannabis firms in obtaining financing through traditional banks stem from the regulatory and legal uncertainties surrounding the industry, the federal prohibition on cannabis, and the risk aversion of financial institutions. While alternative financing options exist, they often come with limitations but still can assist in providing capital to help with industry growth. Addressing these challenges requires a comprehensive approach, involving legislative reforms, regulatory clarity, and industry collaboration to create a supportive environment that enables cannabis firms to access the necessary financial resources for growth and development. However, even with all the financial headwinds cannabis firms face, the industry continues to grow at a staggering pace.

Sources:

1. The Global Cannabis Report; Growth & Trends Through 2025.  
<https://newfrontierdata.com/global-cannabis/>
2. Memorandum from James M. Cole, Deputy Attorney Gen. to All United States Attorneys Regarding Guidance Regarding Marijuana Enforcement (Aug. 29, 2013)