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## Development Finance and the Cannabis Industry

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**BNY MELLON**



# Development Finance and the Cannabis Industry



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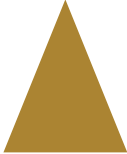
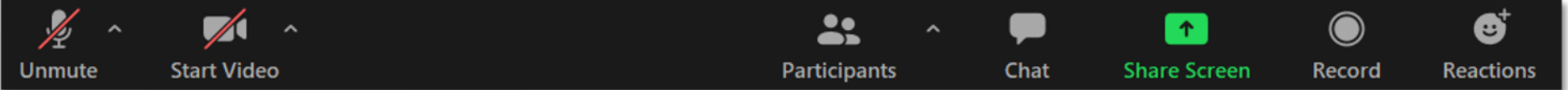
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# Development Finance and the Cannabis Industry



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# BNY Mellon Development Finance Webcast Series

*Development Financing and the Cannabis Industry*

(July 19, 2022)

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# Cannabis Investing:

Lots of opportunities to invest in cannabis (marijuana and hemp)

- 2018: App. \$14 billion invested into cannabis
- 2019: App. \$11.5 billion invested into cannabis
- 2020: App. \$2.6 billion invested into cannabis
- 2021: App. \$2.8 billion raised by 9 largest MSOs alone
  - Average seed-stage investment: \$1.86 Million
  - Average Series B raise (\$18.96 Million) and Series C raise (\$101.67 Million).
  - According to MJ Biz Daily, the marijuana industry added app. \$92 billion to the U.S. economy in 2021.
    - \$160 billion projected per year by 2025.

# Cannabis Investing

## Top 10 CSE Financings – 2021

Issuer Name	Symbol (s)	Deal Type	Public Type	Close Date	Currency	CDN \$M	HQ
Curaleaf Holdings, Inc.	CSE: CURA; OTCQX: CURLF	Debt	Brokered	2021-12-21	USD\$	614	MA
Trulieve Cannabis Corp.	CSE: TRUL; OTCQX: TCNNF	Debt	Brokered	2021-10-06	USD\$	441	FL
Curaleaf Holdings, Inc.	CSE: CURA; OTCQX: CURLF	Equity	Shelf Prospectus	2021-01-12	CDN\$	317	MA
Trulieve Cannabis Corp.	CSE: TRUL; OTCQX: TCNNF	Equity	SEC Form S-1	2021-04-12	CDN\$	288	FL
Green Thumb Industries Inc.	CSE: GTII; OTCQX: GTBIF	Debt	Non-brokered	2021-04-30	USD\$	267	IL
Ascend Wellness Holdings, Inc.	CSE: AAWH.U; OTCQX: AAWH	Debt	Brokered	2021-08-30	USD \$	265	NY
Cresco Labs Inc.	CSE: CL; OTCQX: CRLBF	Debt	Non-brokered	2021-08-23	USD \$	253	IL
TerrAscend Corp.	CSE: TER; OTCQX: TRSSF	Equity	Non-brokered	2021-01-28	CDN\$	224	ON
RIV Capital Inc.	CSE: RIV; OTCQX: CNPOF	Convertible Debenture	Non-brokered	2021-08-25	USD\$	189	ON
Curaleaf Holdings, Inc. /Curaleaf International	CSE: CURA; OTCQX: CURLF	Equity	Non-brokered	2021-04-07	US\$	164	MA

# Is Marijuana Really Legal?

Marijuana is illegal under federal law:

- Schedule I controlled substance under Controlled Substance Act
- Other relevant federal marijuana-related laws:
  - Maintaining drug-involved premises (21 U.S.C. 856)
  - Drug paraphernalia (21 U.S.C. 863)
  - Aiding and abetting (18 U.S.C. 2)

# Is Marijuana Really Legal?

## Banking and Marijuana:

- Illegal to engage in a financial transaction knowing that the property involved represents proceeds from unlawful activity, including sale of marijuana in violation of CSA (18 U.S.C. 1956(a)(1))
- Financial institutions must report suspicious transactions relevant to a possible violation of the law (31 U.S.C. 5318(g))
- Broker / dealer firms fall within the definition of “financial institution” under the Bank Secrecy Act (31 U.S.C. 5312(a)(2)(H))

# Is Marijuana Really Legal?

Despite marijuana remaining illegal under federal law, numerous states have passed laws legalizing marijuana within their borders:

- According to 2019 census, more than 141 million Americans live in states that have legalized marijuana
  - 19 states have legalized adult-use recreational marijuana
    - Colorado, California, Nevada, Illinois, Michigan, Massachusetts, Arizona, New York and New Jersey
  - 39 states plus Washington D.C. have legalized medical marijuana
    - Minnesota (accidentally legalized edibles and beverages in 2022), Florida, Missouri, Mississippi, Oklahoma, Utah, Hawaii



# Conflict Resolution: State vs. Federal Laws

## Federal government guidance for marijuana industry

- Ogden Memo (Oct. 2009)
  - DOJ is committed to enforcement of CSA because Congress has determined that marijuana is a dangerous drug, and its sale and distribution is illegal.
  - DOJ is also committed to making efficient and rational use of its limited investigative and prosecutorial resources and DOJ's priority on CSA prosecution "should not focus on federal resources in States on individuals whose actions are in clear and unambiguous compliance with existing state laws."

# Conflict Resolution: State vs. Federal Law

- First Cole Memo (Aug. 2013)
  - Identified eight (8) marijuana-related enforcement priorities for the DOJ:
    - Distribution to minors.
    - Revenue going to criminal enterprises, gangs and cartels
    - Diversion from states where it is legal to states where it is illegal
    - Marijuana activity being used as a cover or pretext for trafficking other illegal drugs or engaging in other illegal activity
    - Violence and use of firearms in marijuana activities
    - Drugged driving and exacerbation of other adverse public health consequences
    - Growing on public lands or in a manner that creates environmental dangers
    - Possession or use on federal property

# Conflict Resolution: State vs. Federal Law

## FINCEN Guidance (Feb. 2014)

- Clarifies how financial institutions can provide services to marijuana-related businesses consistent with Bank Secrecy Act obligations
  - Requires consideration of number of factors including business objectives of financial institution, evaluation of risks with products / services, and capacity to manage risks effectively.
  - Requires thorough customer due diligence including:
    - Verification of licensing and registration
    - Reviewing license application and other information available from licensing and enforcement authorities
    - Understanding of normal and expected activity for the business
    - Ongoing monitoring for suspicious activities including red flags listed in FINCEN Guidance
    - Refreshing DD information on a periodic basis
    - ***Traditional KYC requirements on steroids***

# Conflict Resolution: State vs. Federal Law

## FINCEN Guidance (cont'd)

- After conducting DD on client, financial institution must file an appropriate Suspicious Activity Report:
  - “Marijuana Limited” SAR – believes that marijuana-related business does not implicate a First Cole Memo priority
  - “Marijuana Priority” SAR – believes that marijuana-related business does implicate a First Cole Memo priority
  - “Marijuana Termination” SAR – if necessary to terminate relationship with marijuana-related business due to financial institution’s anti-money laundering program.

# Conflict Resolution: State vs. Federal Law

## Second Cole Memo (Feb. 2014)

- Clarified that investigations and prosecutions of marijuana-related violations of BSA should be subject to same consideration and prioritization as CSA violations under First Cole Memo

## Sessions Memo (Jan. 2018)

- Rescinded Ogden Memo, Cole Memos and FINCEN Guidance
- Industry still uses these memos as guideposts for navigating between state and federal laws regarding marijuana-related activity

## Rohrabacher – Blumenauer Bill

- Annual appropriations bill passed every year since 2014
- Federal funding cannot be spent on prosecuting medical marijuana-related businesses in strict compliance with state laws

# Hemp:

## Hemp is legal under federal law

- 2018 Farm Bill
  - Definition of hemp and amended definition of marijuana under CSA
  - Created state and federal regulatory requirements under USDA oversight
  - Key elements of legalization of hemp:
    - Must be legal hemp (plant or infused-products cannot exceed 0.3% THC)
    - Testing requirements
    - Reporting requirements
    - Non-compliant plant and product handling requirements
    - Corrective action plan requirements
    - Negligent vs. Intentional Violations
  - Hemp cultivation may be legal under USDA-approved state plan or federal plan (for operators in states without a USDA-approved state plan)

# Hemp:

Hemp is legal under federal law . . . sort of!!!

- CBD
  - Food and Drug Administration says CBD is a “drug” – product intended for use in diagnosis, cure, mitigation, treatment or prevention of disease, or intended to affect the structure or any function of the body
    - FDA has approved only one cannabis-related drug – Epidiolex
    - CBD considered illegal by FDA
  - Many states follow the FDA’s position on CBD
    - California – CBD is illegal until FDA changes its position, unless legally sold as a marijuana product
  - FDA enforcement against the low-hanging fruit:
    - Health or medical-related claims
    - Labelling mistakes
    - Marketing mistakes (dietary supplement)

# Hemp:

- Smokable Hemp
  - Not regulated by FDA as a “tobacco product,” but could be regulated by FDA as a “drug”
  - Virtually impossible for law enforcement to distinguish from marijuana without testing
  - Not legal in many states:
    - Indiana (hotly litigated)
    - Texas
    - Iowa
    - Louisiana
    - Hawaii
    - Kentucky



# Social Equity Opportunities:

- Most states include a social equity component in their marijuana business licensing and operations regulations:
- What is social equity?
  - Social equity is “impartiality, fairness and justice for all people in social policy. Social equity takes into account systemic inequalities to ensure everyone in a community has access to the same opportunities and outcomes. Equity of all kinds acknowledges that inequalities exist and works to eliminate them.”

# Social Equity Opportunities:

- ***Different approaches to social equity in marijuana businesses:***
- Illinois:
  - Based upon ownership (majority) and number of employees in marijuana business.
    - Reside in disproportionately impacted communities.
    - Previously convicted of violating marijuana laws.
  - Automatically awards 50 application points to social equity applicants.
  - Provides technical assistance and support for pre- and post-licensing, legal assistance, and loan application assistance.
  - Eligibility for reduced license and application fees, and access to low-interest loans for start-up costs.

# Social Equity Opportunities:

- Arizona:
  - Social equity licenses required to develop and implement policies to provide a benefit to one or more communities disproportionately impacted by enforcement of prior Arizona marijuana laws.
  - Social Equity Eligibility:
    - Majority owned by individuals with 3 of 4 criteria:
      - Annual household income less than 400% of poverty line.
      - Directly adversely affected by enforcement of prior marijuana laws.
      - Indirectly adversely affected by enforcement of prior marijuana laws against relative (spouse, parent, child, sibling or legal guardian).
      - Lived 3 years between 2016-2020 in disproportionately impacted community.

# Social Equity Opportunities:

- California:

- Allows for development and implementation of social equity programs by the cities:
  - City of Los Angeles.
  - City of Long Beach.
  - City of Oakland.
  - City of San Francisco.
  - City of Coachella.
  - City of Sacramento.

# Fundraising for Cannabis Businesses:

Different types of investment opportunities into marijuana

- Companies traded on Canadian exchanges (CSE and TSX)
- Convertible notes
- M&A
- MSOs
- SSOs
- Technology platforms
- Public finance
- New states
- Ancillary product and service providers
- Non-plant touching spin-offs and U.S. markets

# Fundraising for Cannabis Businesses:

Different types of investment opportunities into hemp

- Cultivation
- Extraction
- CBD
- Fiber
- Testing
- Ancillary product and service providers
- Access to U.S. markets

# Fundraising for Cannabis Businesses:

- Understanding the market:
  - Limited license states vs unregulated license states.
  - Medical vs. adult use
  - Vertical integration vs. individual license states
  - Social equity programs and impact on the state market
  - Impact of local zoning and opt out provisions for local municipalities
  - Limitations on ownership and ability to transfer licenses
  - Comparing the extremes – California, Oklahoma, Pennsylvania and Minnesota
  - The impact of the illicit market

# Fundraising for Cannabis Businesses:

- Impact of federal legal status:
  - Limitations on traditional banking
  - Limitations on traditional financing
  - Concerns regarding reputational risk
  - Potential for asset seizure
  - Limitations on inventory and equipment as collateral
  - Intellectual property – USPTO
  - Federal court jurisdiction
  - Bankruptcy / restructuring protection



# Fundraising for Cannabis Businesses:

- Hidden costs impacting marijuana operators:
  - Green tax
  - HOST fees
  - Banking fees
  - Tenancy costs
  - 280E
  - Legal and accounting expertise
  - Valuation expertise
  - Fundraising expertise

# Questions?

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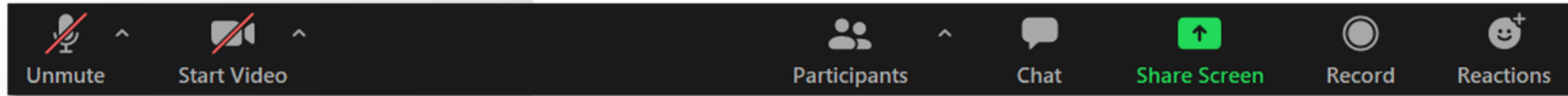
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# Audience Questions



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### CDFA National Development Finance Summit

November 2 - 4, 2022 // Denver, CO

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