



**National Association *of*
Insurance Commissioners**

**REGULATORY GUIDE
UNDERSTANDING THE MARKET FOR CANNABIS INSURANCE**

NAIC White Paper

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**Drafted by the
Cannabis Insurance (C) Working Group
of the
Property and Casualty Insurance (C) Committee**

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I. INTRODUCTION

A. EXECUTIVE SUMMARY

The cannabis industry is evolving and expanding as more states legalize either or both medicinal and recreational cannabis use throughout the U.S. With new entrepreneurs, investors, large corporate businesses, companies going public and executives entering the market, there is a new level of sophistication to the cannabis industry. The state-legalized cannabis businesses, like any other businesses, face a variety of risks and would like to have access to insurance to mitigate these risks. It is important for state insurance regulators to understand the insurance needs of the cannabis industry and to consider steps to address insurance needs in their respective state markets. Several state insurance regulators have taken steps successfully to encourage insurers to provide insurance for state-legalized cannabis businesses. However, major cannabis insurance gaps exist in many states and even in those states that have encouraged successfully the entrance of insurers into the cannabis insurance market.

The National Association of Insurance Commissioners (NAIC) Cannabis Insurance (C) Working Group was formed in August 2018 to identify insurance issues, gaps and opportunities facing the cannabis industry and to identify best regulatory practices to address these issues—starting with developing a white paper. The purpose of this white paper is to provide information to state insurance regulators, insurers and the broader public about the architecture of the cannabis business supply chain, types of insurance needed by the cannabis industry, the availability of cannabis business insurance in state insurance markets and the extent of insurance gaps, and best practices that state insurance regulators can adopt to encourage insurers to write insurance for the cannabis industry.



B. CANNABIS

The cannabis market rapidly changed over the last few years and continues to change on a daily basis. In 2017, the cannabis industry took in nearly \$9 billion in sales. Nationally, in 2018, the overall marijuana industry was worth \$10.4 billion¹ and is anticipated to bring in \$21 billion in 2021.² Other estimates project that by 2022, the cannabis industry will create an estimated \$80 billion in sales annually.³ “In 2017, sales

1. Kachelriess, R., 2019. “By the Numbers: A Year of Cannabis in 2018,” accessed at www.leafly.com/news/industry/by-the-numbers-year-of-cannabis-2018.

2. Smith, A., 2018. “The U.S. Legal Marijuana Industry is Booming,” accessed at <https://money.cnn.com/2018/01/31/news/marijuana-state-of-the-union/index.html>.

3. Greencamp.com, accessed at <https://greencamp.com/recreational-cannabis-market-projections-for-2022/>.

of medical and recreational cannabis in the U.S. were nearly nine times higher than Oreos and almost on par with Americans' collective spending on Netflix subscriptions. With the addition of California's recreational market sales in 2018, cannabis sales could easily eclipse McDonald's annual U.S. revenue."⁴

Additionally, a majority of the U.S. population supports cannabis legalization. About six in 10 Americans say the use of cannabis should be legalized.⁵ Since April 2019, cannabis is legal for medicinal use in 33 states and Washington, DC, and cannabis is legal for recreational use in 10 states and Washington, DC.

Not only is cannabis a growing industry, but also it is a significant employer. In 2017, the cannabis industry employed 121,000 people. With the current trajectory, the number of workers could reach 292,000 by 2021.⁶ These jobs can range from budtenders⁷ and extraction technicians to employees at ancillary companies that generate a large portion of revenue from the cannabis industry. The industry is projected to add as many as 340,000 full-time jobs by 2022. This type of increase in job availability is significant; but, despite the demand for employees in the cannabis sector, there remains an issue with inconsistent positions on the legality of cannabis.

One of the most complex issues facing the cannabis industry is the different treatment of cannabis under federal and state law in states that have legalized cannabis. Despite being legal in many states, at the federal level, cannabis is a Schedule 1 substance that is illegal to manufacture, distribute or sell in the U.S.⁸ Currently, federal law also prohibits the sale of cannabis for medical and adult recreational use. Because cannabis is illegal at the federal level, many individuals are not comfortable working in a field where their employment could be considered illegal. Moreover, financial institutions are hesitant or unwilling to work with cannabis companies. Most banks prohibit cannabis-based businesses from opening accounts, which has led to the cannabis industry being mostly cash-based. This proves problematic as cannabis businesses often find it difficult to engage in standard business practices such as paying employees and vendors. It also

4. *MSN Money*, accessed at <https://www.msn.com/en-us/money/markets/us-retail-marijuana-sales-to-reach-up-to-dollar10-billion-this-year/ar-AAx15Nk>.

5. Hartig, H., and A. Geiger, 2019. "About Six-in-Ten Americans Support Cannabis Legalization," Pew Research Center, accessed at www.pewresearch.org/fact-tank/2018/10/08/americans-support-marijuana-legalization/ft_18-01-05_marijuana_line_update/.

6. Smith, A., 2018. "The U.S. Legal Marijuana Industry is Booming," accessed at <https://money.cnn.com/2018/01/31/news/marijuana-state-of-the-union/index.html>.

7. Budtender—a person who serves customers at an establishment where cannabis is sold. Weedmaps, accessed at <https://weedmaps.com/learn/dictionary/budtender/>.

8. U.S. Drug Enforcement Administration. "Drug Scheduling," accessed at www.dea.gov/drug-scheduling.

makes many cannabis-based businesses targets for criminal activity because of the increased risk of robberies and other theft-related crimes.

In states that have legalized cannabis, some community banks and credit unions are providing banking services to the cannabis industry, but in other locales, state-chartered financial institutions are unavailable. For example, during a regulatory tour, Delaware regulators witnessed one vendor to the market (that was not growing or selling cannabis) receive notice from its state-chartered bank that it would no longer be doing business with the company because of its involvement in the cannabis industry. The magnitude of this concern should not be ignored. “An estimated 70 percent of cannabis businesses have no relationship with a financial institution and thus use cash for all transactions, including salaries for employees.”⁹

The U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) has issued guidance for financial institutions to follow regarding reporting revenues from the cannabis industry in those states in which cannabis is legal, which reflects the Treasury Department’s recognition that some banks and credit unions are providing banking services to the cannabis industry. “Surplus lines insurers mainly focus on the development of new coverages and the structuring of policies and premiums appropriate for risks. New and innovative insurance products for which there is no loss history are difficult, if not impossible, to appropriately price using common actuarial methods. Often, after a new coverage has generated sufficient data, the coverage eventually becomes a standard product in the admitted market.”¹⁰ Despite the risks, state insurance regulators should encourage insurers who choose to enter the cannabis market to do so on the admitted market to drive the costs of policies down and make cannabis insurance more accessible for the cannabis industry.

C. Insurance Gaps

The following list shows the different types of cannabis businesses that are in the supply chain: cannabis cultivation, processors/harvesters, manufacturing, retail, distribution, testing labs and microbusinesses.

⁹ Leavenworth, Stuart. 2018. “When Does Too Much Cash Become a Health Risk? When You Own a Marijuana Shop,” McClatchy DC Bureau, accessed at <https://www.mcclatchydc.com/news/nation-world/national/article198941964.html>

¹⁰ National Association of Insurance Commissioners (NAIC) 2019. Surplus Lines, accessed at https://www.naic.org/cipr_topics/topic_surplus_lines.htm

Below is a list of the types of insurance most frequently needed by the cannabis industry:

- Automobile, including Distribution (auto and cargo)
- Commercial General Liability
- Crop (Indoor/Outdoor)
- Crime Insurance
- Disaster Coverage
- Director and Officer Liability
- Employment Practices Liability
- Equipment Breakdown
- Errors and Omissions
- Excess/Umbrella
- General Liability
- Product Liability
- Premises Liability
- Property
- Surety Bonds
- Workers' Compensation

As the industry continues to expand, there are more cannabis businesses to insure. No longer is cannabis just the flower used for smoking; the market has expanded to oils, shatter, wax, edibles, topical products, the beauty industry, and other cannabis-infused products. However, even with the increased market activity, many insurers are not willing to write cannabis insurance products due to the cannabis industry's inability to bank, the federal illegality, and the unknown risks associated with insuring cannabis businesses. Insurance is essential the security and safety of cannabis businesses, their employees, and their customers. Lack of insurance for the industry adds layers of unnecessary risk and exposure for all market participants.

While cannabis laws vary from state to state, the types of risks facing the cannabis industry generally remain the same. Many of the risks the cannabis industry faces are no different from any other business in the same area of business activity. Outdoor cannabis cultivators face the same risks that other cultivators or agricultural industry businesses face. Outdoor cannabis cultivators, for example, would be most vulnerable to adverse weather conditions and theft, which is not too different from other types of outdoor crop cultivators. The distinguishing factor with outdoor cannabis crops versus other types of outdoor crops is the federal illegality. For example, a cannabis farmer in Carpinteria, CA, was able to use his insurance policy with a payout in excess of \$1 million after ash from

the 2017 southern California Thomas Fire destroyed thousands of his cannabis plants.¹¹ Ash from the Thomas Fire seeped into the cannabis farmer's greenhouse and contaminated the cannabis plants with toxic chemicals, which triggered the "atmospheric change" language in the insurance policy.¹² This is the same exposure and the same coverage that applies to any other farm, nursery or orchard. The farmer accordingly filed a claim and received an insurance payout of more than \$1 million. This may be the largest insurance payout given to a legal cannabis business to date.

In contrast, Delaware has not yet identified an insurer willing to write crop insurance for any Delaware cannabis growers. A cannabis farmer cannot get crop insurance in Delaware because he or she is growing cannabis and, consequently, it is considered "untouchable" per se. This difference between states illustrates that some insurers are treating cannabis businesses as regular commercial enterprises and are deciding to make a business risk decision to insure the cannabis industry, despite federal law differences, while in other states, some insurers are not ready to write insurance business risks for the cannabis industry.

The cannabis industry is diverse in the type of insurance it needs from seed to sale. Crop failure and destruction can occur at the nursery and growth stage. Growing cannabis plants and keeping them healthy during the maturation phases is a laborious process. The cannabis is grown from its seedling stage in nurseries. It must be tended to by experienced cannabis farmers and growers and then harvested and trimmed (either by hand or machine). Even within the cannabis industry, there is great disparity between the sizes of companies and their operating and insurance needs. Crops can range from small craft batch cultivation to large scale nurseries. At the cultivation site alone, the types of insurance needed are different from the needs of a manufacturing site. One of the newest types of manufacturing sites is vertical integration locations where cannabis is grown and trimmed, and low-quality flowers are processed into oil and refined into shatter, wax or another concentrate through expensive machinery. Manufacturers will most likely want to insure these products. Once the cannabis product is in a consumable form, it is tested for contaminants and pesticides.

States often require some form of testing to ensure consumer protection. One bad test or pesticide report can make a crop or product completely unsafe and, therefore, unsellable. Many states have a track and trace system that records the movement of cannabis and cannabis products through the commercial supply chain. The cannabis plants are often tagged, and the packaging of cannabis products is marked with serial numbers to identify

11. Brugger, K., 2018. "Cannabis Farmer Gets Over \$1 Million Insurance Payout," *Santa Barbara Independent*, accessed at www.independent.com/news/2018/mar/19/cannabis-farmer-gets-over-1-million-insurance-payo/.

12. Kennedy, B., 2018. "The Cannabist Article: California Cannabis Company Received Historic \$1 Million Insurance Payout Following Fire," *Cannabis Insurance Professionals*, accessed at www.cannabisinsuranceprofessionals.com/news.

the chain of liability. This allows for the ease of pinpointing exactly where contamination occurred.

The ability to have insurance is critical, and these controls should make insurers confident that they can selectively underwrite this business. This ability to pinpoint exactly where the product contamination occurred helps to identify which cannabis producer should be accountable for a bad batch of cannabis products and, in turn, which insurer will be responsible for paying the claims.

As the cannabis industry continues to expand in states and U.S. territories, insurance availability lags behind the needs of the cannabis industry. Sectors of the cannabis industry that need to be insured include ancillary cannabis businesses, cannabis-infused product manufacturers, cannabis dispensaries, cannabis events, cannabis growers and harvesters, cannabis landlords, cannabis distributors and transporters, cannabis medical physicians, cannabis waste facilities, cyber liability, and more.

Insurance companies have hesitated to enter the admitted market due to little data, as well as the unknown risk factors. There is not only an increased need for insurance by the cannabis industry, but there is also a need for insurance with the roll-out of state and local licensing requirements. As regulations shift from being general to specific, many local and state licensing authorities require insurance. States such as California and Massachusetts require proof of insurance, such as a general liability policy, for cannabis business applicants seeking licensure from state and local jurisdictions.^{13,14}

The risk tolerance differences between state regulatory systems can also be stark. For instance, to access a Delaware retail medical marijuana outlet, a patient must first enter a vestibule with locked doors on either end: one for ingress and the other egress. Patients are scanned in the vestibule when entering a facility. They must produce both a driver's license (or other state ID) and their Medical Marijuana Program (MMP) card before gaining entrance to a second locked chamber. Once there, patients pass their same ID to the intake processor. Only after satisfying the intake specialist protocol, the patient gains admittance to the store itself. No electronics are permitted in a Delaware cannabis store. In states that have legalized cannabis, security concerns are a prime concern of retail operators. However, state insurance regulators' security protocols differ for retail outlets.

13. State of Massachusetts, Code of Massachusetts Regulations, Title 935, Cannabis Control Commission, Code of Massachusetts Regulations §§ 500.101(c)(5) and (6) and § 500.105(10).

14. State of California, Bureau of Cannabis Control Proposed Text of Regulations, California Code of Regulations Title 16, Division 42. Bureau of Cannabis Control Regulations §§ 5008, 5308, 5312, 5709.

As the size of the cannabis industry continues to increase, the need and the demand for insurance in the cannabis industry correspondingly increases. State insurance regulators will be forced to deal with the intersection of cannabis and insurance. They should be ready by educating themselves about the cannabis industry and the various types of insurance risks associated with it.

This white paper will focus on the federal, state and local authority; seed-to-sale operations; the type, scope and availability of coverage and insurance gaps; and regulatory best practices and recommendations. State insurance regulators, should they choose to do so, can play an important role in encouraging insurers to write insurance for the cannabis industry.

II. OVERVIEW OF KEY AUTHORITIES

A. FEDERAL AUTHORITY

Legalization of cannabis for any purpose is a topic that has been discussed and debated for decades. While cannabis was once prohibited nationwide, in the 1970s, 12 states either removed or reduced the penalties for possession of small amounts of cannabis.¹⁵ By the late 1970s, the momentum had stalled and would remain that way until the beginning of the 21st century.

However, by 2018, 33 states; Washington, DC; and the territories of Guam and Puerto Rico had legalized the use of cannabis for medical reasons.¹⁶ Ten states, and Washington, DC, now also permit the recreational use of cannabis.¹⁷ Certainly, the pendulum of public opinion has swung since the late 1970s, with fewer people seeing cannabis as harmful when compared to 20 years ago.¹⁸ While one reason for this change may be generational, public opinion has perhaps also been swayed by the rise in laws permitting the use of medical marijuana.

“Medical marijuana” refers to the use of cannabis, which may involve use of the entire plant or its extracts—most frequently, delta-9-tetrahydrocannabinol (THC) and/or cannabidiol (CBD)—as a physician-recommended form of medicine to treat symptoms of

15. Alaska, California, Colorado, Maine, Minnesota, Mississippi, Nebraska, New York, North Carolina, Ohio, Oregon and South Dakota. (South Dakota later reversed its decriminalization of the drug.)

16. National Conference of State Legislators, 2018. “State Medical Marijuana Laws,” accessed at www.ncsl.org/research/health/state-medical-marijuana-laws.aspx.

17. National Conference of State Legislators, 2018. “State Medical Marijuana Laws,” accessed at www.ncsl.org/research/health/state-medical-marijuana-laws.aspx.

18. Bachman, J.G., L.D. Johnston, P.M. O’Malley, and J.E. Schulenberg, 2012. “Monitoring the Future National Survey Results on Drug Use, 1975–2011,” *Vol. I: Secondary School Students*, Ann Arbor, MI: Institute for Social Research, University of Michigan.

illness and other conditions.¹⁹ By 2019, 12 states had enacted laws permitting the use of products rich in CBD, which does not have psychoactive effects. Currently, the U.S. Food and Drug Administration (FDA) has not recognized or approved the use of cannabis as medicine, due to its classification as a Schedule I substance under the federal Controlled Substances Act (CSA) of 1970. However, researchers continue to explore its possible uses for medical treatment. Now that hemp-derived CBD is legal, retailers continue to sell CBD products in all 50 states, claiming that they are derived from industrial hemp plants and, therefore, are legal. To date, this is a position that has received mixed treatment from the federal government.²⁰

While not addressing every law or regulation that may apply to cannabis-related businesses or consumption, the following section will illustrate the myriad of laws that may complement or contradict each other. As will be seen, the legal and regulatory framework governing cannabis is in a constant state of flux. This constant change has led to great uncertainty in the cannabis industry with regard to business operations throughout the industry.

Signed into law by President Richard Nixon on Oct. 27, 1970, the CSA²¹ is the federal U.S. drug policy under which the manufacture, importation, possession, use and distribution of certain narcotics, stimulants, depressants, hallucinogens, anabolic steroids and other chemicals are regulated. Any addition, deletion or change to schedule designation of a medicine or substance may be requested by the U.S. Drug Enforcement Agency (DEA), the U.S. Department of Health and Human Services (HHS), the FDA or from any other party via petition to the DEA.

The DEA implements the CSA and may prosecute violators of the laws set forth in the CSA at both the domestic and international level. Within the CSA, there are federal schedule designations (I–V) that are used to classify drugs based upon their:

- Abuse potential
- Accepted medical applications in the U.S.
- Safety and potential for addiction²²

19. National Institute on Drug Abuse, 2018. "Marijuana as Medicine," accessed at www.drugabuse.gov/publications/drugfacts/marijuana-medicine.

20. *High Times*, 2017. "DEA: CBD Oil Is Not 'Legal in All 50 States,'" accessed at <https://hightimes.com/news/politics/dea-cbd-oil-is-not-legal-in-all-50-states>, but see W.M. Schuster and J. Wroldsen, 2018. "Entrepreneurship and Legal Uncertainty: Unexpected Federal Trademark Registrations for Marijuana Derivatives," *American Business Law Journal*, (55)1: 117.

21. Controlled Substances Act of 1970, 21 U.S.C. § 801, *et seq.*

22. Drugs.com, 2018. "CSA Schedules," accessed at www.drugs.com/csa-schedule.html.

Cannabis is regulated as a Schedule I substance. Schedule I substances are those that have a high potential for abuse and for which there are currently no accepted medical uses in treatment in the U.S.²³

At the federal level, the government's authority to regulate and control cannabis can be broken into three distinct categories: 1) criminal; 2) administrative; and 3) civil. While these categories are not mutually exclusive and often overlap, conceptualizing the federal level of control in this way is helpful to understand how federal law regulates cannabis and interacts with state and local law. It is also important to bear in mind that the executive, legislative and judicial branches of the federal government all have a role to play in each of these categories, and often, each branch seems to take a different approach in the regulation and control of cannabis.

B. Federal Criminal Laws

As mentioned above, cannabis is a Schedule I drug for purposes of the CSA, which triggers certain other federal criminal statutes. Of primary concern for this section, cannabis's prohibited status triggers three main federal criminal laws when individuals engage in transactions involving cannabis or proceeds from cannabis. The first, the federal Bank Secrecy Act (BSA),²⁴ requires financial institutions to report to the Treasury Department any transactions over \$5,000 that the institution knows, or has reason to know, involve assets derived from illegal sources.

"Financial institution" is defined broadly and includes banks, credit unions, broker-dealers, insurance companies, pawnbrokers, travel agencies and a host of other institutions that may come into contact with assets derived from illegal sources. Because cannabis is a prohibited substance, any institution that transacts business with a cannabis or cannabis-related entity is subject to these reporting requirements. The penalty for a violation of the BSA is severe: up to a \$250,000 civil penalty and up to five years in prison. Any transaction associated with a cannabis business must be reported under the BSA, even if that activity is legal under state law, and a violation of the BSA may result in a financial institution's loss of its charter.

The second federal statute implicated in transactions involving cannabis is the money laundering statute.²⁵ This statute makes it a felony for any person to engage in a financial transaction that the individual knows involves the proceeds of an unlawful activity. Because cannabis is a prohibited substance, any transaction that derives proceeds,

23. U.S. Drug Enforcement Administration, 2018. "Drug Scheduling," accessed at www.dea.gov/drug-scheduling.

24. 31 U.S.C. §§ 5301, et. seq.

25. 18 U.S.C. §§ 1956–7.

directly or indirectly, from cannabis transactions could be considered money laundering for the purposes of the money laundering statute. The penalties for violating this statute are severe: up to a \$500,000 civil penalty or twice the value of the property involved in the transaction, whichever is greater, and up to 20 years in prison.

The third federal statute implicated by cannabis transactions is the unlicensed money transmitter statute.²⁶ Under this statute, it is a felony to engage in an unlicensed money transmitting business. The statute defines “unlicensed money transmitting business” to include a transaction that involves the transportation or transmission of funds that are known to have been derived from a criminal offense or are intended to be used to promote unlawful activity. Because of this definition, any transaction that involves the transmission or transportation of funds derived, directly or indirectly, from the cannabis industry is a violation of the unlicensed money transmitter statute and subjects the individual to up to five years’ imprisonment.

In enforcing these statutes, the executive branch has, on the one hand, been consistent and on the other hand inconsistent. Regarding clearly illegal cannabis activities, the executive branch has been consistent in its enforcement and prosecution of such activities. However, the executive branch has been less consistent in its treatment of cannabis in states where it has become legal. For example, in February 2014, then Deputy Attorney General James Cole issued a memorandum that announced guidance to U.S. Department of Justice (DOJ) attorneys on the Obama administration’s priorities in the prosecution of cannabis-related federal crimes.²⁷ Intended to update federal guidance considering ongoing changes to state laws, it applied to all federal enforcement activity, both civil and criminal, in all states.

Noting that the DOJ had previously issued memoranda setting forth federal enforcement priorities in jurisdictions that authorized cannabis cultivation and distribution for medical use, Deputy Attorney General Cole concluded that, with some exceptions, the federal government would again exercise discretion in its enforcement determinations in jurisdictions that had implemented strong, effective regulatory and enforcement systems to control the cultivation, distribution, sale and possession of cannabis for industrial or recreational use.²⁸ While noting that any cannabis transaction was prosecutable, the Cole

26. 18 U.S.C. § 1960.

27. U.S. Department of Justice, 2014. “Guidance Regarding Marijuana Related Financial Crimes,” accessed at www.justice.gov/sites/default/files/usao-wdwa/legacy/2014/02/14/DAG%20Memo%20-%20Guidance%20Regarding%20Marijuana%20Related%20Financial%20Crimes%202%2014%2014%20%282%29.pdf.

28. Continued priorities included preventing the distribution of marijuana to minors and preventing revenue from the sale of marijuana going to criminal enterprises.

Memorandum indicated that the DOJ would not actively seek to prosecute legalized cannabis transactions.

The exceptions to the Cole Memorandum were eight federal priorities for prosecution, including criminal enterprises, sale to minors, growing cannabis on public grounds, and preventing diversion of legal cannabis into states where cannabis was illegal. However, in January 2018, former Attorney General Jeff Sessions rescinded the Cole Memorandum by way of his own memorandum that emphasized the DOJ's "well-established principles" with regard to the prosecution of cannabis crimes.²⁹ While the memorandum did not specifically address legalized cannabis, it did indicate a return to a more active DOJ role in regulation and control of cannabis. The federal guidance previously issued by former Attorney General Sessions leaves financial institutions that now accept money from cannabis-related businesses potentially exposed to violations of federal law, including money laundering statutes. In 2019 Attorney General William Barr indicated he will not pursue cannabis businesses that are operating legally within their state jurisdiction.³⁰ Insurers have no assurance that the Attorney General's comments extend to financial institutions engaging with cannabis businesses, nor, is there any guarantee that this policy extends beyond the tenure of the Attorney General who made the statement. Insurers must assess a business risk decision about whether they will provide services to the cannabis industry.

The federal judiciary has been more consistent in its interpretation of the CSA and related cannabis prohibitions. The U.S. Supreme Court, in its landmark 2005 *Gonzales v. Raich* opinion, reaffirmed the supremacy of the CSA over state legalization statutes.³¹ Since the *Gonzales* decision, the judiciary has upheld criminal prosecutions involving cannabis transactions, even where legalized at the state level. To date, the Supreme Court has not expressed a willingness to revisit the *Gonzales* decision. Similarly, lower federal courts have shown a reluctance to address the issue of state legalized cannabis.

In February 2018, a federal judge dismissed a lawsuit seeking to legalize cannabis under federal law. The plaintiffs in that suit argued that the CSA's classification of cannabis as a Schedule I substance is unconstitutional and that the federal cannabis policies in the U.S. discriminate against minorities. In dismissing the suit, the judge found that the plaintiffs should first petition the DEA to ask that it be removed from the list of dangerous substances, as that agency, along with the FDA, oversees the classification and

29. U.S. Department of Justice, 2018. "Marijuana Enforcement."

30. CBS News, 2019. "Trump's Attorney General Nominee May Shift Policy on Marijuana Enforcement," accessed at www.cbsnews.com/news/william-barr-on-marijuana-legalization-attorney-general-nominee/.

31. *Gonzales v. Raich*, 545 U.S. 1 (2005).

scheduling of the drug. Given these judicial developments, state legalization of cannabis does not pose a bar to prosecution in the federal judiciary.³²

The legislative branch, however, has been ambivalent to state-legalized cannabis. In 2003, in the face of several states legalizing cannabis on some level, U.S. Rep. Maurice Hinchey (D-NY) brought an amendment to the House floor that would have prohibited the DOJ from expending funds to prosecute state-legalized cannabis operations.³³ While this amendment would ultimately fail by a 152-273 vote, by 2014 the amendment was revived by U.S. Rep. Dana Rohrabacher (R-CA) and had been included as an amendment to the 2014 omnibus spending bill.³⁴ Since the enactment of this amendment, Congress has reapproved it yearly in appropriations bills. Other legislative enactments, however, have seen less enthusiasm from Congress.

On June 7, 2018, U.S. Sen. Cory Gardner (R-CO) and U.S. Sen. Elizabeth Warren (D-MA) introduced the Strengthening the Tenth Amendment Through Entrusting States (STATES) Act (S. 3032 and H.R. 6043). The STATES Act was aimed at amending the CSA to exempt cannabis-related activities that were in accordance with state laws. It also sought to protect banks working with cannabis businesses and legalize at the federal level the cultivation of industrial hemp. No action has been taken on this bill since it was referred to the Committee on the Judiciary. Also, on June 7, 2018, an identical bill (H.R. 6043) sponsored by U.S. Rep. David P. Joyce (R-OH) was introduced in the House of Representatives. H.R. 6043 was referred to the Subcommittee on Crime, Terrorism, Homeland Security, and Investigations on July 30, 2018, and no action has been taken on that bill since.³⁵

In March 2019, the House Financial Services Committee voted in favor of advancing the SAFE Banking Act (H.R. 1595), which would allow cannabis businesses to work with banks and credit unions.³⁶ It would bar federal regulators from terminating a bank's FDIC deposit insurance, a threat that prevents most banks from accepting cannabis businesses. One of the greatest obstacles of entry for admitted market insurers is the threat of felonious liability under federal law. The SAFE Banking Act would remove some of the direct conflict between state and federal law barriers for insurer and broker

32. Huddleston Jr., T., 2018. "Why a Federal Judge Dismissed a Lawsuit That Could Have Legalized Marijuana Nationwide," *Fortune Magazine* accessed at <http://fortune.com/2018/02/27/federal-judge-dismiss-lawsuit-marijuana-legalization-jeff-sessions>. See also, *Bortell, et al. v. Sessions, et al.*, Case No. 1:17-cv-5625, U.S. District Ct. for the Southern District of New York.

33. Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 2004, H.R. 2799, H. Amdt. 297 (2003).

34. Commerce, Justice, Science, and Related Agencies Appropriations Act, 2015, H.R. 4660, H.Amdt.748 (2014).

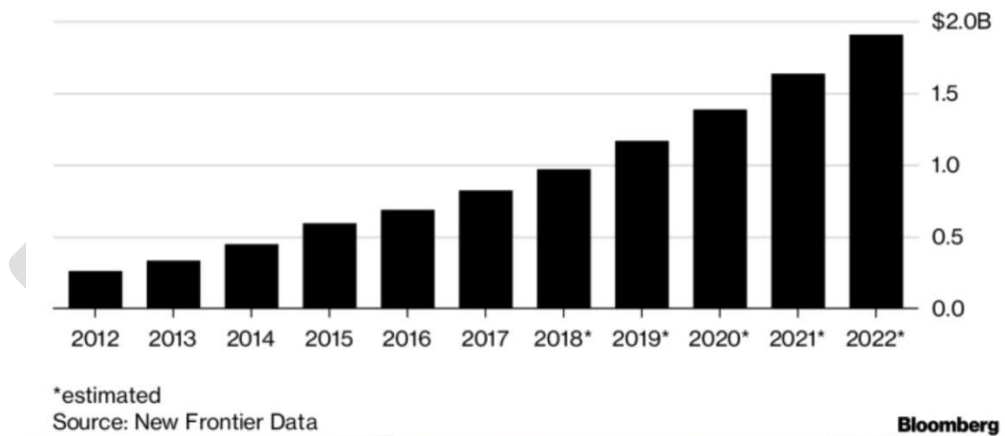
35. National Cannabis Industry Association. Accessed at <https://thecannabisindustry.org/government-affairs/priority-legislation-us-senate/>.

36 Congress.gov. Accessed at <https://www.congress.gov/bill/116th-congress/house-bill/1595/all-actions?overview=closed#tabs>.

participation in the cannabis market. H.R. 1595 has been referred to another committee, but the bill's advancement is a significant step for the cannabis industry. With the bill's passage, it is likely that more banks would open their doors to cannabis businesses. In turn, cannabis businesses would be able to operate as normal businesses. The regulatory landscape of the cannabis industry is evolving rapidly. Thus, it's critical to stay up-to-date on federal and state cannabis-related legislation. Doing so ensures the insurance industry's underwriting risk assessment and client policy advisement reflects recently passed laws.

Recent developments on both the federal and state levels support the notion that as the commercial investment and scientific research intersect with changing public attitudes about cannabis usage, the risk management portfolio of firms on the supply side will expand to meet market needs. With passage of the new farm bill in 2018, Congress moved to fully legalize hemp,³⁷ opening the way for broad distribution of CBD products and creating the first cannabis market insurers may find to be a much more palatable risk.

U.S. Hemp-Based Product Sales



Driving demand is CBD, a non-psychoactive cannabinol that can be derived from hemp or cannabis. CBD is one of the substances in cannabis, but in hemp, it comes with no mind-altering effect from THC. Proponents say CBD helps relieve pain, anxiety, nausea and inflammation. Currently sold mostly online and in specialty shops, CBD can be found in oils, candies, capsules and even sparkling water. In June 2018, the FDA approved the

37. Kaskey, J., 2018. "Pending Legislation Makes Insurance Available to Hemp Growers," *Property Casualty 360*, accessed at www.propertycasualty360.com/2018/11/29/pending-legislation-makes-insurance-available-to-hemp-growers/?slreturn=20190312125750.

first CBD-based medicine, Epidiolex, made by GW Pharmaceuticals to treat childhood epilepsy.

C. Federal Regulatory Level

At the federal regulatory level, state-legalized cannabis faces numerous challenges as individuals engaged in business in the cannabis industry attempt to navigate a host of complex federal regulatory regimes. While it is impossible to enumerate every point at which the cannabis industry interacts with federal regulatory regimes, some of these include banking, finance and insurance; securities; environmental protection; intellectual property; taxation; and agriculture, just to name a few.

D. Financial Services Sector

The first area of regulatory authority is in the financial services sector. As noted above, many of the criminal laws that are implicated by legalized cannabis are financially orientated, and lack of access to banking and financial services even in states where cannabis is legal is a significant issue. For example, in order to comply with the BSA, financial institutions must send Suspicious Activity Reports (SARs) to the Treasury Department when the institution is involved in a transaction involving funds over \$5,000 that the institutions knows, or has reason to know, come from illegal sources, such as cannabis.³⁸

Beyond mere compliance with federal criminal law, a host of other regulations complicate financial transactions involving legalized cannabis. For example, for financial institutions to be able to transmit funds electronically through the Federal Reserve's electronic network, the institution must have a master account with the Federal Reserve. However, the Federal Reserve has been reluctant to provide master accounts to institutions that deal exclusively in legal cannabis due to the federal prohibition on cannabis, leaving such institutions without the ability to transmit money.³⁹ There are exceptions such as Colorado, which has a limited scope and strict parameters, but it does have a Federal Reserve account. Even where cannabis businesses attempt to raise funds outside the ordinary banking system, federal regulations may pose a barrier. If a cannabis business seeks to raise capital through the issuance of securities, such securities must be registered by the U.S. Securities and Exchange Commission (SEC) unless the security

38. 31 CFR § 1020.320.

39. *Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City*, 861 F.3d 1052 (10th Cir. 2017).

falls within an exemption.⁴⁰ It is unclear whether the SEC would approve such securities given the prohibited status of cannabis.

In response to these concerns, and in recognition of the Obama administration's deprioritizing of criminal prosecution of cannabis-related businesses in cases where they are otherwise compliant with the laws of the state in which they are operating, on February 14, 2014, FinCEN issued its own guidance. This guidance was intended to clarify how financial institutions can provide services to such businesses while remaining compliant with their obligations under the BSA. It instructed financial institutions providing such services—when they reasonably believed, based on their due diligence, that a given business did not implicate the Cole Memorandum's priorities or state law—to file a "Marijuana Limited" SAR. Further, a financial institution that reasonably believed a cannabis-related business was violating a Cole Memorandum priority or state law was instead instructed to file a "Marijuana Priority" SAR, and FinCEN's guidance set forth the "red flags" that would suggest the business was engaged in such activity.⁴¹ Despite the guidance issued by Attorney General Sessions in 2018, FinCEN has stated that the structure set forth in its 2014 guidance remains in place.⁴² What FinCEN's guidance did not and could not do, however, was amend federal law or grant immunity to a financial institution providing services to a cannabis-related business.

Despite FinCEN's guidance, the number of financial institutions accepting this risk dropped slightly in the months that immediately followed its issuance. It has, however, grown steadily since then. According to FinCEN, by the end of March 2018, 411 banks and credit unions were "actively" operating accounts for marijuana-related businesses.⁴³ States continue their attempts to navigate these murky waters between federal and state law. By way of example, in 2014, Colorado passed a law that would allow the formation of "cannabis credit co-ops." These co-ops were to function similarly to a credit union and had restrictions on the number of businesses they could serve.⁴⁴ Despite the passage of this bill, no co-ops have been formed under this law.⁴⁵ Several other state initiatives have

40 Frank Robison, *Going Green: Legal Considerations for Marijuana Investors and Entrepreneurs*, 6 A. U. Bus. L. Rev. 57 (2016).

41. Those subject to FinCEN's regulations were still required to report currency transactions in connection with marijuana-related business the same as they otherwise would.

42. Angell, T., 2018. "Congressional Committee Protects Medical Marijuana from Jeff Sessions," *Forbes*, accessed at www.forbes.com/sites/tomangell/2018/05/17/congressional-committee-protects-medical-marijuana-from-jeff-sessions/#546c1ca11e55.

43. Angell, T., 2018. "More Banks Working With Marijuana Businesses, Despite Federal Moves," *Forbes*, accessed at www.forbes.com/sites/tomangell/2018/06/14/more-banks-working-with-marijuana-businesses-despite-federal-moves/#39002b6b1b1b.

44. House Bill 14-1398. Accessed at www.leg.state.co.us/clics/clics2014a/csl.nsf/fsbillcont3/06F7F4159729909387257CCA0082B929?Open&file=1398_enr.pdf.

45. Miyoga, D., 2014. "Promise for Pot-Banking Co-Op Sees Little Progress Since It Was Law," *The Denver Post*, accessed at www.denverpost.com/marijuana/ci_26525249/promise-pot-banking-co-op-sees-little-progress.

been introduced since.⁴⁶ On July 3, 2018, the New York State Department of Financial Services published its own guidance to encourage banks and credit unions to offer services to marijuana-related businesses licensed by the state and advised them to continue to follow FinCEN's 2014 guidance. Still, given the risk of not only losing their charter but also the threat of facing criminal prosecution for a federal offense, many financial institutions have been hesitant to embrace the cannabis business.

E. Intellectual Property

The cannabis industry faces other complications related to federal regulation. One example of this is in the area of intellectual property. As the cannabis industry has become legitimized, many cannabis businesses such as growers, distributors, and retailers have sought to protect their intellectual property in brand names, business names and similar identifiers. However, the U.S. Patent and Trade Office (USPTO) has historically taken the position that trademarks cannot be granted to applications promoting or involving illegal conduct.⁴⁷ To date, the USPTO has not approved any filings for trademarks or copyrights for products related to cannabis. Interestingly, however, the USPTO has approved trademarks for certain cannabis derivatives. Specifically, the USPTO has approved trademarks for specific types of CBD products. As noted above, these approvals stemmed from confusion as to whether CBD was illegal under the CSA. This confusion has since been resolved. However, the CBD trademarks are still valid and still exist. Thus, while the USPTO has seemed to take a straightforward approach to the registration of cannabis trademarks, there is still some inconsistency in how the USPTO previously handled such trademarks.

F. Environmental and Agricultural Regulations

One last area of interest worth noting is the cannabis industry's interaction with environmental and agricultural regulations. Cannabis, after all, is an agricultural product, which gives rise to environmental concerns. There are two key areas of concern at the federal level in this regard: 1) the federal Clean Water Act (CWA); and 2) the provision of water rights from federally administered facilities. The CWA regulates, in part, the pollution generated by agriculture operations. However, the CWA relies, in large part, on federal-state cooperation.⁴⁸ The CWA is largely implemented at the state level using

46. Morton, H., 2018. "2014–2018 Financial Institutions and Cannabis/Hemp/Marijuana Legislation," National Conference of State Legislators Legislative Summit, accessed at https://comm.ncsl.org/productfiles/112183917/Financial_Institutions_Cannabis_Hemp.pdf.

47. Schuster, W.M. and J. Wroldsen, 2018. "Entrepreneurship and Legal Uncertainty: Unexpected Federal Trademark Registrations for Marijuana Derivatives," *American Business Law Journal*, 55(1): 117.

48. Stoa, R.B., 2017. "Marijuana Agriculture Law: Regulation at the Root of an Industry," *Florida Law Review*, (69)2: 297. U.S. Department of Justice, 2014. "Guidance Regarding Marijuana Related Financial Crimes," accessed at <https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1361&context=flr>.

federal funds and grant projects. Given the prohibited status of cannabis at the federal level, it is unclear whether such grants would be available to states for cannabis remediation projects. Indeed, state programs aimed at environmental cleanup and partnership with the cannabis industry have been subject to federal raids and subpoenas.⁴⁹

An additional agricultural concern arises regarding water rights and irrigation. In particular, regulatory complexities arise for cannabis growers in the western U.S., who must contend with the U.S. Bureau of Reclamation (USBR). The USBR is the largest wholesaler of water in the U.S. and provides one out of five western farmers with irrigation water.⁵⁰ Because of the prohibited status of cannabis under the CSA, the USBR has issued guidance stating that it will not approve the use of its facilities for the cultivation of cannabis.⁵¹ As such, cannabis cultivators and growers may find it difficult to find the water sources necessary to support their growth operations.

G. Civil Level

At the civil level, the federal judiciary has created confusion as to civil obligations. This section will highlight two of significant importance: 1) the enforceability of contracts; and 2) the ability to declare bankruptcy. The enforceability of contracts brings questions on whether contracts involving cannabis transactions are void against public policy. Without guidance from the U.S. Supreme Court, lower courts have been left to address this issue as a matter of first impression.

In *Tracy v. USAA Casualty Insurance Company*, the District Court for the District of Hawaii was asked to determine whether a contract of insurance was enforceable against an insurer in order to provide coverage for legal cannabis plants that had been lost during a fire.⁵² The Court in that case determined that since cannabis is illegal under the CSA, the Court would decline enforcing the contract on the grounds that it was against public policy. As such, no coverage was available under the policy. The opposite conclusion was reached in the District Court for the District of Colorado. In *Green Earth Wellness Center, LLC v. Atain Specialty Insurance Company*, the Court was asked whether a policy of insurance could cover legal cannabis plants that were damaged due to a wildfire.⁵³ In addressing the “void as against public policy” argument, the Court reasoned that over the years, the federal public policy had eroded; thus, there no longer existed a clear and

49. Flatow, N., 2013. “How the Drug Enforcement Administration Killed a County Program to Police Pot,” accessed at <https://thinkprogress.org/how-the-drug-enforcement-administration-killed-a-county-program-to-police-pot-91815d4e5148/>.

50. Bureau of Reclamation. “About Us – Fact Sheet,” accessed at www.usbr.gov/main/about/fact.html.

51. Bureau of Reclamation. “Use of Reclamation Water or Facilities for Activities Prohibited by the Controlled Substance Act of 1970,” accessed at www.usbr.gov/recman/temporary_releases/pectrmr-63.pdf.

52. *Tracy v. USAA Casualty Insurance Company*, No. 11-00487 LEK-KSC, 2012 WL 928186 (Mar. 16, 2012 D. Haw).

53. *Green Earth Wellness Center, LLC v. Atain Specialty Insurance Company*, 163 F.Supp.3d 821 (D. Colo. 2016).

consistent public policy against legalized cannabis. As such, the Court expressly declined to follow *Tracy* and found that the contract of insurance provided coverage for legal cannabis plants. While there appears to be a trend of courts following *Green Earth* as opposed to *Tracy*, until there is a definitive ruling on this issue by the Supreme Court, the enforceability of contracts involving cannabis will still be a point of contention.

One last area of concern at the civil level is the ability of cannabis-related businesses to declare bankruptcy. The ability of a business to seek bankruptcy protection is essential to a business when operations prove unsuccessful. However, this tool may not be available to cannabis-related businesses. In the case *In re: Arenas*, the 10th Circuit Court of Appeals was asked to determine the availability of bankruptcy protections for cannabis growers.⁵⁴ In that case, after litigation returned a negative verdict against the cannabis growers, the growers sought bankruptcy protection. The U.S. Trustee objected to the bankruptcy, and the bankruptcy court dismissed the petition due to the criminal nature of the business. The 10th Circuit affirmed the dismissal, reasoning that since the substantial assets of the estate were cannabis, and since cannabis was illegal under federal law, the U.S. Trustee could not administer the bankruptcy estate without violating federal law.⁵⁵ As such, the Court ruled that dismissal of the bankruptcy was permissible. As with the enforceability of contracts, until guidance is provided by the Supreme Court, there will be uncertainty as to whether bankruptcy protections are available to cannabis-related businesses. In addition, different states have distinctive laws allowed in bankruptcies, such as a homestead exemption, so there are no general bankruptcy laws applicable to all states.

H. McCarran-Ferguson Act

One of the areas unique to insurance is how the federal laws affecting cannabis interact with the federal McCarran-Ferguson Act.⁵⁶ The McCarran-Ferguson Act precludes federal law from preempting state law regarding the business of insurance unless the federal law specifically relates to the business of insurance. Arguments have been made that because the CSA does not specifically apply to the business of insurance, state laws governing cannabis insurance are not preempted; therefore, states are free to engage the cannabis insurance industry without concern of federal liability.⁵⁷ However, the

54. *In re Arenas*, 535 B.R. 845 (10th Cir. 2015).

55. See also, *In re Rent-Rite Super Kegs West Ltd*, 484 B.R. 799 (D. Colo. 2012) (Dismissing a Bankruptcy Petition Because Marijuana Remains Illegal Under the CSA).

56. 15 U.S.C. § 1011.

57. Queen, M., 2017. "The Growing Cannabis Industry and Captive Insurance," *Insurance Journal*, accessed at www.insurancejournal.com/magazines/magfeatures/2017/10/16/467075.htm.

nuances of how federal cannabis laws interact with the federal McCarran-Ferguson Act have not been clearly explored, and uncertainty still exists in this regard.

While it is true that the CSA does not specifically relate to the business of insurance, this, in and of itself, does not save a state statute regulating cannabis insurance from preemption. While the fixing of rates, regulation of advertising of insurance policies, and the licensing of companies and their agents are clearly the business of insurance and, therefore, are not subject to preemption under the federal McCarran-Ferguson Act,⁵⁸ other aspects of cannabis insurance regulation are not so clearly regulating the business of insurance as to prevent preemption. For example, the Supreme Court has held that priority provisions of state insolvency law, to the extent that they are attempting to provide for priority of payments beyond policyholders, are not saved from preemption under the federal McCarran-Ferguson Act.⁵⁹ Thus, state insurance regulators may find that their authority to orderly liquidate an insurer may, to a greater or lesser extent, be preempted by the CSA.

Another example of where a state's law may not be protected by the federal McCarran-Ferguson Act is in the field of corporate transactions. While the licensing of insurers is clearly protected by the federal McCarran-Ferguson Act, the Supreme Court has held that the SEC may unwind transactions that are in violation of federal securities law.⁶⁰ Therefore, a state insurance regulator may approve a transaction involving a cannabis insurer only to see it unwound by the SEC on the grounds of illegality.

Putting aside the CSA, other federal laws directly affecting the cannabis insurance industry are clearly not protected by the federal McCarran-Ferguson Act. Specifically, the criminal statutes mentioned above (the BSA, the money laundering statutes and the unlicensed money transmitted statute) are all not subject to the anti-preemption provisions of the federal McCarran-Ferguson Act. This is because each of these laws specifically relates to the business of insurance. Each of these acts specifically defines financial institutions to include insurers⁶¹; therefore, on the statutes' face, the anti-preemption provisions of the federal McCarran-Ferguson Act do not apply. As such, the federal government may enforce these criminal provisions against both the industry and potentially state insurance regulators. Indeed, courts that have been faced with the question of whether the federal McCarran-Ferguson Act bars prosecution under these statutes have found no such bar to exist.⁶²

58. *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453, 460 (1969).

59. *U.S. Department of Treasury v. Fabe*, 508 U.S. 491 (1993).

60. *SEC v. National Securities, Inc.*, 393 U.S. 453, 460 (1969).

61. 31 U.S.C. § 5312(a)(2)(M); 18 U.S.C. § 1956(c)(6)(A).

62. *U.S. v. Blumeyer*, 114 F.3d 758 (8th Cir. 1997); *U.S. v. Cavin*, 39 F.3d 1299 (5th Cir. 1994).

Despite issues at the federal level, states recognize the additional revenue that could be generated by the sale of marijuana, and those that currently have this income stream are using it to fund projects they may not otherwise have been able to afford. For example, Colorado is using the first \$40 million of tax revenue to fund school construction costs, and Nevada intends to earmark 40% of its wholesale tax to the state's Distributive School Account (DSA). Others intend to use the extra money to fund drug treatment and enforcement programs.⁶³

The additional revenue, however, may not come without a cost. To balance public safety concerns with the rights of individual users, cities and towns are also beginning to regulate the use of medical and recreational marijuana. The myriad of local laws further complicates the landscape as evidenced by the attempt to summarize the specific policies for all 482 cities in the state of California.⁶⁴ This summary serves to further illustrate the patchwork of laws and lack of uniformity with respect to this issue.

III. SEED-TO-SALE OPERATIONS—AN OVERVIEW AND ARCHITECTURE OF THE CANNABIS INDUSTRY

A. OVERVIEW

States have taken varying approaches to regulating the cannabis industry. While some states regulate medical and recreational cannabis separately, others have delegated authority to a single administrative agency. For example, Oregon has had a medical cannabis program since 1998 and a recreational program since 2016. The medical program is run by the Oregon Health Authority (OHA), which registers and regulates medical cannabis patients, medical cannabis growers, grow sites, processors, dispensaries and caregivers. OHA also promulgates cannabis testing rules. The recreational program is run by the Oregon Liquor Control Commission (OLCC), which licenses producers, wholesalers, processors, laboratories, retailers and researchers. The OLCC also issues permits for individual workers in the recreational cannabis industry.

In contrast, both medical and recreational cannabis in Colorado are regulated by the Colorado Department of Revenue (DOR). Medical cannabis was decriminalized through

63. Wells Fargo Advisors, 2018. "Trump May Support Less Federal Intrusion on State Marijuana Laws," accessed at www.wellsfargoadvisors.com/research-analysis/asg/marijuana-impacts-on-municipal-bonds.htm.

64. The Cannifornian, 2018. "Searchable Database: See How Cannabis Laws, Support Differ Among California Cities," accessed at www.thecannifornian.com/cannabis-business/database-see-cannabis-laws-support-differ-among-california-cities/.

an amendment (Amendment 20) to the Colorado Constitution in 2000. Recreational cannabis was added in 2012 (Amendment 64).

Colorado and Oregon represent two versions—one separate and one unified—of the regulation of the cannabis industry. As cannabis remains illegal under federal law, individual states have, and increasingly are, legalizing parts of the cannabis industry and setting up regulatory structures unique to their respective states. It can be anticipated that as these regulatory structures mature, there will be increased emphasis on unification and coordination to avoid regulatory pressure points caused by differing legal and regulatory schemes.

B. Cultivation

The cannabis cultivation component of the industry has developed along two paths: 1) a “cottage” industry of small-scale craft cultivation (i.e., cultivation for home and/or personal use); 2) and the development of large-scale producers engaged in cannabis as a commercial crop. There are further subdivisions between recreational and medicinal cannabis.

States typically allow residents to grow a limited number of home-grown cannabis plants for personal use,⁶⁵ while registered medical and recreational cannabis caregivers can produce in greater quantities. Registered medical cannabis producers are often required by states to be vertically integrated in some way with the rest of the supply chain. For example, registered growers in Oregon must be designated by a patient to produce cannabis on their behalf. The patient may designate themselves or another person as their grower. There are 16,600 registered growers who are producing at 13,959 grow sites.

In Colorado, medical cannabis caregivers who cultivate more than 36 plants must register with the Colorado Department of Public Health and Environment and disclose: 1) the location of each cultivation; 2) the cannabis registration identification number for each patient they serve; and 3) any extended plant count numbers (patients with physician

65. Oregon residents are allowed up to four homegrown plants per residence. (ORS 475B.301) Colorado home grow laws allow no more than 12 plants in any residence. Counties and municipalities may have stricter laws in place. The plants must be kept in an enclosed, locked space and inaccessible to anyone under 21 years of age living in or outside of the residence. (Colorado Marijuana Official State Web Portal: www.colorado.gov/pacific/marijuana/home-grow-laws.)

recommendations exceeding six plants and their patient registry numbers).⁶⁶ As of December 2018, caregiver cultivation registrations numbered 1,963.⁶⁷

Medical marijuana cultivators (“optional premises cultivation” (OPC) or “grow” operations) in Colorado must be vertically integrated or associated with a licensed medical marijuana center (a business that sells medical cannabis to patients or primary caregivers, but is not, itself, a primary caregiver) or a licensed manufacturer who creates products infused with medical cannabis intended for use/consumption other than by smoking.⁶⁸ There were 673 licensed medical cannabis cultivation entities in Colorado in January 2019.⁶⁹

In contrast to the medical cannabis grow operations, the recreational side shows significantly larger-scale operations. In Oregon, there are 1,108 licensed recreational producers who participate in some aspect of producing, cultivating, growing and drying cannabis. In Colorado, there were 735 recreational cultivation entities in January 2019. Although there was a similar number of medicinal cultivation entities, the monthly average ratio of cannabis plants cultivated as of June 30, 2018, was almost 3:1 recreational over medicinal.⁷⁰

There are often more stringent limits on the amount of medical cannabis that can be produced as compared to the limits for recreational cannabis. For example, in Oregon, the largest non-grandfathered medical-only producer is limited to 48 mature plants.⁷¹ On the other hand, the largest-tier outdoor recreational producer is not limited by the number of plants and can produce on as much as 40,000 square feet of land.⁷² In Colorado, recreational cannabis cultivators can grow up to 1,800 plants at a time (Tier 1), and after one harvest season of sales, may seek authorization to grow more plants at progressive increments up to the tier in excess of 13,800 plants (Tier 5).⁷³

66. Colorado Department of Revenue, 2018. *2018 Sunset Reviews: Colorado Medical Marijuana Code and Colorado Retail Marijuana Code*, pp. ii, 57–58, accessed at www.colorado.gov/pacific/sites/default/files/2018%20Sunset%20reivew%20report.pdf.

67. Colorado Department of Public Health & Environment. “MED Caregiver Cultivation Registration,” accessed at www.colorado.gov/pacific/enforcement/med-caregiver-cultivation-registration.

68. Colorado Department of Revenue, 2018. *2018 Sunset Reviews: Colorado Medical Marijuana Code and Colorado Retail Marijuana Codes*, pp. 21 and 34, accessed at www.colorado.gov/pacific/sites/default/files/2018%20Sunset%20reivew%20report.pdf.

69. Colorado Marijuana Official State Web Portal, accessed at www.colorado.gov/pacific/med-resources-and-statistics.

70. Colorado Department of Revenue, 2018. *MED 2018 Mid-Year Update*, pp. 4–6; accessed at www.colorado.gov/pacific/sites/default/files/MED%202018%20Mid%20Year%20Update.pdf.

71. ORS 475B.831.

72. OAR 845-025-2040.

73. Colorado Department of Revenue, 2018. *2018 Sunset Reviews: Colorado Medical Marijuana Code and Colorado Retail Marijuana Code*, Oct. 15, 2018, pp. 19 and 28; accessed at www.colorado.gov/pacific/sites/default/files/2018%20Sunset%20reivew%20report.pdf.

C. Distribution, Manufacturing and Delivery/Transportation

States have taken varying approaches to licensing the distribution, manufacturing and transportation of cannabis products. In Oregon, wholesalers purchase cannabis from licensed producers (cultivators). They may dry, trim, arrange for lab testing, package, store and deliver cannabis to retailers. There are 139 licensed wholesalers in Oregon.⁷⁴ Processors extract oils from cannabis plants and package them into vaporizers or vaporizer cartridges. Processors may also produce cannabinoid extracts and bulk oil used for manufacturing edibles or topical products. Edible manufacturers are required to obtain a processor license. There are 204 licensed processors in Oregon, with three registered processors in the medical cannabis program.^{75,76}

Colorado's regulatory system is different in that a cultivation facility is licensed to cultivate, prepare and package recreational cannabis and sell it to retail stores, product manufacturing facilities or other retail cultivation facilities. Consequently, Colorado does not have a wholesaler category. However, it does have separate categorizations for medicinal and recreational manufacturers who concentrate and make products for consumption other than by smoking, including edibles, ointments and tinctures.⁷⁷ There are 239 medical infused product manufacturers and 282 recreational product manufacturing facilities in Colorado as of January 2, 2019.⁷⁸

In Oregon, an entity must be a licensed producer, wholesaler, processor, laboratory or retailer in order to transport cannabis. Wholesalers may provide transportation services to other licensees throughout the supply chain. Colorado's structure provides for licensure of a transporter. A medical cannabis transporter is a person or business that transports medical cannabis from one business to another and may include the provision of logistics, distribution and storage of medical cannabis and manufactured medical cannabis products. There are 10 medical cannabis transporters licensed in Colorado. On the recreational side, there are 13 transporters licensed in Colorado.⁷⁹

74. Oregon Liquor Control Commission, November 2018. For current data, visit www.oregon.gov/olcc/marijuana/Documents/mj_app_stats_by_county.pdf.

75. Oregon Liquor Control Commission, November 2018. For current data, visit www.oregon.gov/olcc/marijuana/Documents/mj_app_stats_by_county.pdf.

76. Oregon Health Authority, 2018. *Oregon Medical Marijuana Program Statistical Snapshot October 2018*, accessed at www.oregon.gov/oha/PH/DISEASES/CONDITIONS/CHRONICDISEASE/MEDICALMARIJUANAPROGRAM/Documents/OMP%20Statistical%20Snapshot%2010-2018.pdf.

77. Colorado Department of Revenue, 2018. *2018 Sunset Reviews: Colorado Medical Marijuana Code and Colorado Retail Marijuana Code*, pp. 19 and 29, accessed at www.colorado.gov/pacific/sites/default/files/2018%20Sunset%20reivew%20report.pdf.

78. Colorado Department of Revenue, 2019. *MED Resources and Statistics*, as of Jan. 2, 2019, accessed at www.colorado.gov/pacific/enforcement/med-resources-and-statistics.

79. Colorado Department of Revenue, 2019. *MED Resources and Statistics*, as of Jan. 2, 2019, accessed at www.colorado.gov/pacific/enforcement/med-resources-and-statistics.

D. Retail and Consumers

Retailers sell items directly to consumers. Medical cannabis dispensaries receive cannabis, immature cannabis plants or cannabis products and transfer them to a patient or a patient’s caregiver. There are approximately five registered dispensaries in Oregon. Retailers are responsible for verifying the age of every customer for every purchase. Retailers may sell usable cannabis, cannabinoid products, cannabinoid extract or concentrate, immature plants, and cannabis seeds. There are 598 licensed recreational cannabis retailers in Oregon⁸⁰ and approximately 620 licensed cannabis retailers in California⁸¹

In Colorado, as of November 1, 2018, there are 477 distinct licensed medical cannabis centers; of those, there are 413 unique licensees. There are 547 distinct licenses held for recreational retail stores; of those, there are 457 unique licensees.⁸² There are several products available to the consumer, which fall under the flower and non-flower categories. In Oregon, cannabis flower represented 54.4% of recreational sales in 2018, followed by concentrate/extract at 29.4% and edible products at 10.3%. All other products represent roughly 6% of sales.

The flower also holds most of the market share in Colorado at 54.1% of recreational and 61.2% of medicinal use.⁸³ In 2015, the non-flower products were about 25% of total sales. In 2017, the non-flower products sales jumped to 37.7% of the regulated market. The non-flower products include concentrate, edibles and non-edibles.

Recreational Sales by Type of Product			
<u>State</u>	<u>Flower</u>	<u>Extract/Concentrate</u>	<u>Edibles</u>
OR (2018)	54.4%	29.4%	10.3%
CO (2017)	54.1%	23.4%	13.4%

⁸⁰ Oregon Liquor Control Commission, November 2018. For current data, visit www.oregon.gov/olcc/marijuana/Documents/mj_app_stats_by_county.pdf.

⁸¹ California Bureau of Cannabis Control, April 23, 2019, accessed at <https://aca5.accela.com/bcc/customization/bcc/cap/licenseSearch.aspx>

⁸² Colorado Department of Revenue, 2018. *MED Licensed Facilities*, as of Dec. 3, 2018, accessed at www.colorado.gov/pacific/enforcement/med-licensed-facilities.

⁸³ Marijuana Policy Group, 2018. *Market Size and Demand for Marijuana in Colorado 2017 Market Update*, accessed at www.colorado.gov/pacific/sites/default/files/MED%20Demand%20and%20Market%20Study%20082018.pdf.

E. Testing

Testing is an important regulatory component in the cannabis supply chain. States that have legalized the use of cannabis generally require that product be tested by a lab before distribution to a dispensary and sale to the consumer. Labs use a variety of testing methods based on different products (oils, shatter, wax, edibles, topical products, etc.) in order to determine potency—the amount of THC, CBD and pesticide concentrations in the product. However, the testing and methodologies have not developed standardized metrics or methods, which leave these aspects open for future research.

All cannabis products in Oregon are required to be tested by a licensed laboratory before being sold to consumers. Laboratories test for contaminants, pesticides, solvents and potency. There are 23 licensed laboratories in Oregon.⁸⁴ In Colorado, under both the recreational and medical cannabis laws, regulated cannabis must be tested in five categories: 1) microbials (bacteria and fungi); 2) mycotoxins (toxins produced by fungi); 3) residual solvents; 4) pesticides; and 5) potency. Licensed retail entities must submit samples of recreational cannabis and recreational cannabis products to a licensed testing facility for testing in the five categories. All medical cannabis products must be labeled with a list of all chemical additives that were used in the cultivation and production of a medical cannabis product. Persons holding a retail testing license may not have an interest in any other cannabis license, either recreational or medical.⁸⁵ Currently, there are 11 each of testing facilities for medical and recreational cannabis in Colorado.⁸⁶

F. Tracking

Oregon and Colorado have several risk management requirements for cannabis-related businesses. Participants in the recreational and medical cannabis industries must use state-administered systems to track inventories throughout the production, processing, transportation, sale and testing of cannabis. Every plant is assigned a unique code and tracked through the supply chain in order to allow for more effective audits, to satisfy federal guidelines and to allow for product recalls when consumer safety issues are present.

84. Oregon Liquor Control Commission, November 2018. For current data, visit www.oregon.gov/olcc/marijuana/Documents/mj_app_stats_by_county.pdf.

85. Colorado Department of Revenue, 2018. *2018 Sunset Reviews: Colorado Medical Marijuana Code and Colorado Retail Marijuana Code*, pp. 19 and 29; accessed at www.colorado.gov/pacific/sites/default/files/2018%20Sunset%20reivew%20report.pdf.

86. Colorado Department of Revenue, 2018. *MED 2018 Mid-Year Update*, pp. 4 and 6, accessed at www.colorado.gov/pacific/sites/default/files/MED%202018%20Mid%20Year%20Update.pdf.

G. Security

Most states require individuals who work in the cannabis industry to obtain some sort of license. The scope of the licensing laws may vary. For example, all employees who perform work on behalf of an Oregon licensed producer, processor, wholesaler or retailer—including, but not limited to, individuals who participate in the possession, securing, or selling of cannabis items—are required to possess a valid cannabis worker permit. In Colorado, all individuals who own or work for a licensed cannabis business must pass a fingerprint-based criminal history background check and demonstrate Colorado residency and financial responsibility. Cannabis businesses must also document their funding sources and ownership structure.

In Colorado and Oregon, all entities in the cannabis supply chain are required to implement certain security precautions, including:

- Video cameras that produce 24/7 high-quality, non-light dependent recordings of all areas where cannabis items are present.
- Armed alarm systems.
- Panic buttons or the equivalent to call for emergency services.
- The ability to lock and secure cannabis items at all times.

H. Existing Economic Impacts

The cannabis industry provides a significant source of jobs and tax revenue in states where it has been legalized. The market is characterized by steady growth. In jurisdictions where recreational cannabis was legalized after the legalization of medical cannabis, recreational production and sales have overtaken the medical side to be the dominant force in the market.

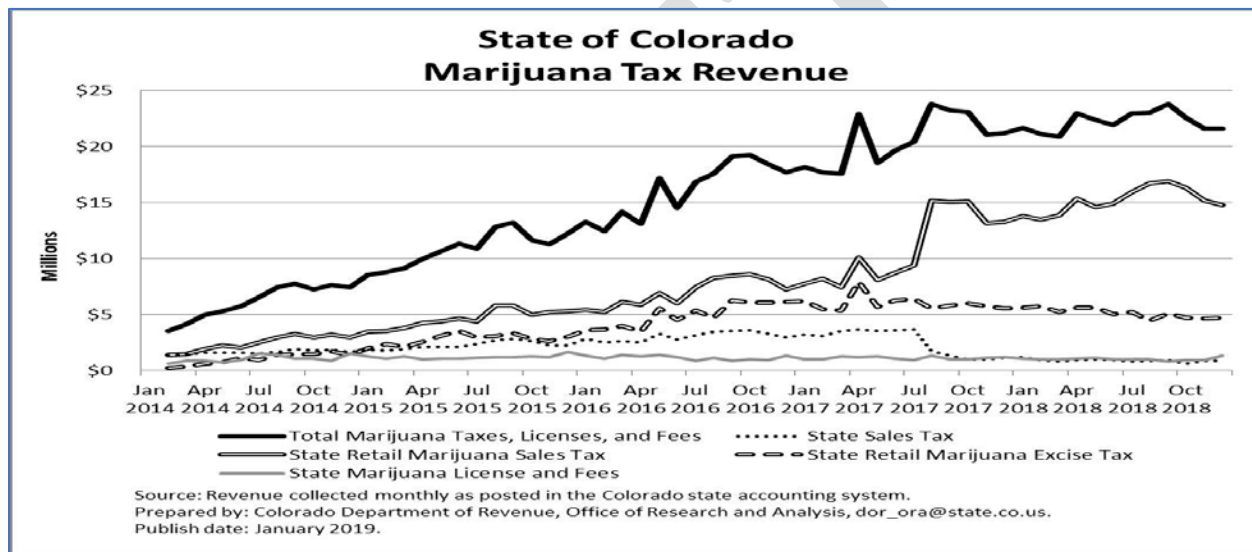
The legalization of cannabis provides employment opportunities directly within the cannabis industry, such as retail stores, dispensaries, cultivation, infused product manufacturing, transportation and laboratory testing. Additional ancillary jobs include security guards, construction and HVAC specialists, consulting, legal, and other business services. In Colorado, as of Nov. 1, 2018, there are 41,429 individuals licensed in the cannabis industry.⁸⁷ There are 36,228 individuals licensed to work in Oregon.⁸⁸

87. Colorado Marijuana Official State Web Portal, accessed at www.colorado.gov/pacific/enforcement/med-resources-and-statistics.

88. Oregon Liquor Control Commission, 2018. *Marijuana License Application Statistics as of November 30, 2018*, accessed at www.oregon.gov/olcc/marijuana/Documents/mj_app_stats_by_county.pdf.

Considering worker turnover, economists estimate that about 12,500 individuals are employed at any one time.⁸⁹

States realize a significant increase in tax revenues from the sale of cannabis. For example, Colorado's revenues from excise and sales tax increased 91.1% from 2014 to 2015 and are expected to increase 23% by 2020 and surpass cigarette revenues.⁹⁰ The tax, license and fee revenue for calendar year 2018 was almost \$267 million.



In Oregon, \$82 million in cannabis tax dollars were collected in FY 2018. This represents a 17% increase from FY 2017.⁹¹ Recreational cannabis tax revenue is expected to increase by another 34% by the 2019–2021 biennium.⁹² Since recreational cannabis became legal in Oregon in 2016, sales have steadily increased. Consumer sales in July 2018 were approximately \$57.5 million, approximately 20% higher than the consumer sales in July 2017.⁹³ Sales of all types of products—including edibles, extracts and usable cannabis—have steadily increased.⁹⁴

89. Whitney, B.R., 2017. *Cannabis Employment Estimates*, accessed at <https://olis.leg.state.or.us/liz/2017R1/Downloads/CommitteeMeetingDocument/99775>.

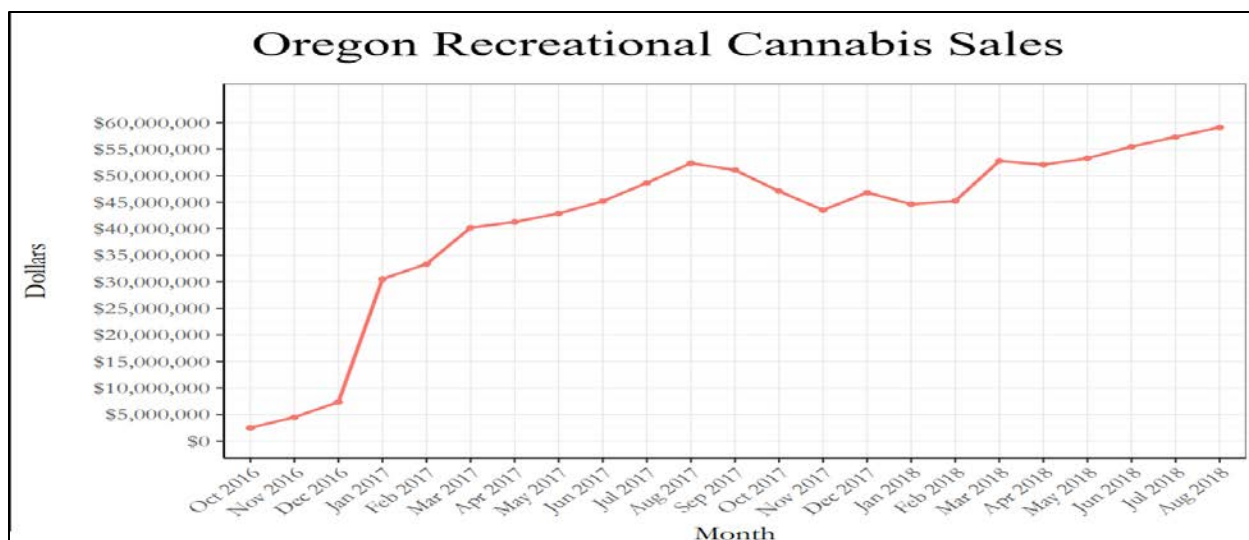
90. Marijuana Policy Group, 2016. *The Economic Impact of Marijuana Legalization in Colorado*, accessed at www.mjpolicygroup.com/pubs/mpg%20impact%20of%20marijuana%20on%20colorado-final.pdf.

91. Oregon Department of Revenue. December 2018. For current data, visit www.oregon.gov/DOR/programs/gov-research/Documents/Financial-reporting-receipts-public.pdf.

92. Office of Economic Analysis, Oregon Department of Administrative Services, 2018. *Oregon Economic and Revenue Forecast, December 2018*, accessed at www.oregon.gov/das/OEA/Documents/forecast1218.pdf.

93. Oregon Liquor Control Commission. December 2018. For current data, visit www.oregon.gov/olcc/marijuana/Documents/CTS/OregonCannabisTrackingSystemData.pdf.

94. Ibid.



Source: OLCC Market Trend Data.

In contrast, the number of medical cannabis growers, processors and dispensaries has declined sharply since 2016, when recreational cannabis was legalized in Oregon.⁹⁵ There has been a significant amount of consolidation in the industry, which has led to frequent ownership changes and continuous business structure modifications.⁹⁶

Nationwide, the *NAMIC Issue Analysis* cites information from the *Marijuana Business Daily* in May 2017 that estimated demand for recreational cannabis approaches \$45 billion to \$50 billion compared to \$106 billion for beer, \$76.9 billion for cigarettes and \$70.3 billion for nutraceuticals.⁹⁷ Moreover, the *NAMIC Issue Analysis* summarizes:

In 2017, the legal medical and adult-use market reached \$8.5 billion, according to the “State of Legal Marijuana Markets” executive report. The same report projects that the U.S. Cannabis market will reach \$23.4 billion by 2022. Another report even likened the industry’s 25 percent compound growth rate through 2021 to cable television at 19 percent in the 1990s and broadband internet at 29 percent in the 2000s. Other reports project the industry would reach as much as \$50 billion by 2026 if marijuana were legalized at the federal level. In addition, medical and adult use retail cannabis tax revenues

95. From October 2015 to October 2018, the number of growers dropped from 48,699 to 16,600. From October 2016 to October 2018, the number of processing sites dropped from 117 to three, and the number of dispensaries dropped from 46 to five. Oregon Health Authority, October 2015, 2016 and 2018. *Oregon Medical Marijuana Program Statistical Snapshot*, accessed at

www.oregon.gov/oha/PH/DISEASES/CONDITIONS/CHRONIC/DISEASE/MEDICALMARIJUANAPROGRAM/Pages/data.aspx.

96. Oregon Liquor Control Commission (OLCC), 2018. “Update on Marijuana Licensing,” accessed at www.oregon.gov/olcc/marijuana/Documents/Bulletins/Licensing_Delay_DirectorsMessage.pdf.

97. Bergner, J., 2018. “Cannabis: From Criminality to Commercial Enterprise Understanding the Intersection with Property/Casualty Insurance.” National Association of Mutual Insurance Companies (NAMIC), accessed at www.namic.org/pdf/publicpolicy/181101cannabis.pdf.

topped \$645 million in 2017 and are expected to hit \$2.3 billion in 2020.⁹⁸

IV. TYPE, SCOPE, AND AVAILABILITY OF COVERAGE AND INSURANCE GAPS

A. INTRODUCTION

The cannabis industry can be broken down into multiple segments. This includes cultivation, processors/harvesters, manufacturing, retail distribution, testing labs, and microbusinesses or affiliated businesses (e.g., construction, security, cargo/transportation companies). While each of these segments is unique and require insurance products specific to their type of business, there are coverages that apply to all the business segments. These coverages include, but are not limited to, general liability, workers' compensation, product liability, and property insurance.

There are a few admitted insurers issuing policies in the cannabis industry, and they are treating cannabis businesses as “regular” businesses despite the federal illegality of the product. One exception to this statement is workers' compensation. Some states—including Colorado, Oregon and California—include a workers' compensation market of last resort through a state-admitted carrier for this coverage. However, most other available insurance products for the cannabis industry are currently insured through the non-admitted (surplus lines) market.

The primary challenge in engaging admitted insurers in many states to write any coverage type is the requirement of a “lawful purpose.” Under general law, any contract or agreement entered for an illegal purpose is not legally binding. Because cannabis continues to be illegal at the federal level, the argument is made that there can be no legal contract or insurance policy. There are legislative efforts underway at both the federal and state level to address this conundrum of legality in a state and illegality at the federal level.⁹⁹

Moving toward an admitted market for cannabis business insurance is a key objective for states that have legalized. This is a rapidly changing area with businesses seeking admitted coverage but only able to find coverage in the non-admitted market. As the

98. Bergner, J., 2018. “Cannabis: From Criminality to Commercial Enterprise Understanding the Intersection with Property/Casualty Insurance,” National Association of Mutual Insurance Companies (NAMIC), accessed at www.namic.org/pdf/publicpolicy/181101cannabis.pdf.

99. See discussion at p. 24.

cannabis industry develops, their insurance needs become more sophisticated and differentiated.

The chart below is intended to provide examples on the needs of the industry ranging from general coverages anticipated for all cannabis businesses to those more specialized for various business segments, such as testing labs.

<p style="text-align: center;">Sample General Insurance Needs for Cannabis Industry (Product Liability)</p>				
<ul style="list-style-type: none"> • Business Owners Policy Programs • Commercial General Liability • Premises Liability • Products/Completed Operations Coverage 				
<p style="text-align: center;">Sample Specialized Coverage Needs by Business Segments</p>				
Cultivation	Processors/ Manufacturers	Testing Labs	Distribution	Retail
<ul style="list-style-type: none"> • Crop Insurance • Equipment Breakdown • Earthquake /Volcanic Eruption /Sprinkler Leakage 	<ul style="list-style-type: none"> • Equipment Breakdown • Errors and Omissions • Directors and Officers Liability 	<ul style="list-style-type: none"> • Equipment Breakdown • Errors and Omissions • Directors and Officers Liability 	<ul style="list-style-type: none"> • Automobile Liability • Cargo 	<ul style="list-style-type: none"> • Employment Practices • Directors and Officers Liability • Employee Theft • Crime Insurance

Other Potential Insurance Needs

- Lessor's Risk
- Medical Professional Liability
- Surety Bonds

B. How Insurers Determine Cannabis Rates

The cannabis insurance market is presently expanding with insurers emerging onto the admitted market. These insurers are submitting rate filings for regulated products, which allows state insurance regulators to gain insights into the types of coverages and design ratemaking approaches with respect to the coverage filings. Preliminary reviews of recent admitted-market filings suggest that policies and coverages offered to cannabis-oriented operations are similar to those provided to other non-cannabis businesses, including various limit and deductible options that are routinely offered in the commercial insurance marketplace. As the cannabis insurance market continues to grow the types of coverage and options do as well.

a. General Observations Regarding Cannabis Insurance Rates

Optional coverages such as earthquake, terrorism and sprinkler leakage are generally available at an additional premium to insureds who elect these coverages. Both rates and minimum premiums can vary on the basis of the nature of the risk (e.g., the classification of the insured as a store, dispensary, grower, warehouse, distributor, and whether the insured grows the product solely for its own use or for sale to other businesses) and the territory (as defined by the insurer in its rating plan). Possible segments include, but are not necessarily limited to, the following: 1) store/dispensary; 2) indoor cultivation; 3) outdoor cultivation; and 4) manufacturing/processing.

Exposure bases for loss costs can be either sales or payroll, as appropriate, based on the coverage and the business operations. For multiplicative increased-limits factors (ILFs), lower factors apply to lower limits of coverage; higher factors apply to higher limits. Claims-made policies are available, with options to choose retroactive dates and extended reporting periods. The further back the retroactive date is in the past, the larger the premium. Premiums for extended reporting periods are determined as percentages of the annual premium.

Schedule rating is often available to adjust the manual rates up to +/-25%, and in infrequent cases up to +/- 40% (also depending on allowable schedule-rating constraints pursuant to the laws of individual states). Some cannabis-specific characteristics that some insurers use in schedule rating include: 1) number and type of cannabis licenses; 2) depth of experience in cannabis operations; and 3) the use of blockchain, including Hyperledger, technology in processing, distribution and retail transactions.

Some rates may be premised on certain packages of coverages being mandatory. For instance, some insurers may require a package of general liability and property coverages to be purchased together, while other coverages—e.g., product liability, crime, earthquake, sprinkler leakage or terrorism—may be optional.

Package discounts for property and liability coverages together may be available, along with multi-policy credits. Rates may be affected by the owner's years of experience and financial position. New ventures may be significantly surcharged, as may inexperienced business owners or insureds with prior bankruptcies.

Rates may also depend on the following attributes: 1) presence of video surveillance; 2) use of locked display/storage cases; 3) use of flammable solvents, tinctures and/or hash oil; 4) local surroundings, including traffic volume and proximity to police services; and 5) the selection and training of employees. Rates may also be premised on the business complying with certain requirements, such as background checks on employees.

b. Businessowners' Policy (BOP) Programs

Classification relativities for various businesses are often derived from existing proxy classifications. For instance, some insurers have noted the following similarities in their filed rating plans:

- Distributors have similarities to warehouses and wholesale businesses, such as baked goods, tobacco, and grocery.
- Testing labs have similarities to businesses specializing in scientific tools and instruments and dental labs.
- Dispensaries have similarities to other retail stores, such as drug stores and tobacco stores.
- Manufacturers have similarities to other small business operation/manufacturing exposures, such as bakeries (no restaurant) and beverage stores (no liquor).

c. Commercial General Liability (CGL) Insurance

Many CGL exposures can be rated with gross sales as the exposure base. However, certain classifications pertaining to transportation and/or distribution may be rated based on payroll, while classifications pertaining to subcontracted work may be rated based the cost of that work. Within a schedule-rating plan, underwriters may consider such criteria of individual risks as: 1) the experience of the management; 2) internal controls; 3) structural features and condition of the building; 4) compliance with safety protocols; 5) types of equipment; and 6) the selection, training and experience of employees.

Loss costs for liability coverages and related endorsements are affected by:

- Applicable limitations on territories.
- Requirements for persons on premises to be escorted by employees.
- Hours of operation.
- Customer age restrictions.
- Type of exit packaging.
- Advertising injury liability, which is affected by restrictions on marketing to youthful persons.
- Requirements for security guards and protective devices. For instance, rates may be affected by: 1) employing state-certified security guards; 2) whether they are employees or subcontractors; and 3) whether they are armed or unarmed.

d. Premises/Operations Coverage

Premises or operations coverage can be rated by area of building. Possible hybrid exposure bases would be the square footage if the building area is smaller and gross sales if the building area is larger. Deductibles per occurrence are often available. The potential for inhalation/exposure liability is likely to be higher than for other typical properties and would be reflected in rates accordingly.

e. Products/Completed Operations Coverage

For products or completed operations coverage, gross sales are a possible exposure base. Rates vary by type of operation; e.g., medical dispensaries may be charged different rates from retail stores. Deductibles per occurrence are often available. There may be a default deductible, and further discounts could apply for the selection of higher deductibles.

f. Optional Coverages for Businessowners' and/or Commercial General Liability Programs

In exchange for additional premiums, the following optional coverages may be available:

- Coverage for risks arising from employment of security guards (rated based on payroll/cost of security guards).
- Hired and non-owned automobile coverage (may be available for flat additional premiums).
- Assault and battery coverage (premium for various sublimits may be calculated as a percentage of the main commercial general liability coverage premium, with variation based on whether defense coverage is within or outside the policy limits).
- Terrorism (federal Terrorism Risk Insurance Act [TRIA]) coverage (premium may be calculated as a percentage of the main commercial general liability coverage premium).
- Waiver of subrogation (may be available for flat additional premium).
- Product withdrawal expense coverage (may be available for flat premium charges, based on the limit of coverage, with deductibles per occurrence set as dollar amounts and/or percentages of the limit of coverage).
- Special event coverage, which may be considered short-term coverage for which premium is fully earned. Premiums may vary depending on the type of event and may be proportional to the duration of the special event in days. Special events may include trade shows, fairs and music festivals. Rates vary based on the perceived level of hazard, which may be categorized as low, moderate or high. Event history, on-site security and limitations on consumer access are all factors taken into consideration.

g. Crime Insurance

Coverages for employee dishonesty, money and securities, and counterfeit money are highly affected by the current cash nature of the business. Rating is highly variable accordingly, with the potential for high premiums to be set. Several large brokerages have represented that the theft hazard is the most significant among the risks faced by cannabis-related businesses today.

h. Crop Insurance

Crop insurance availability is a significant issue because federal crop insurance is not offered for cannabis crops. Private crop insurance for cannabis-related operations is also virtually impossible to secure. Insurers do not wish to cover any product that crosses state lines, due to fear of federal involvement. Accordingly, information regarding rates for crop insurance for cannabis is extremely limited.

i. Earthquake/Volcanic Eruption/Sprinkler Leakage Insurance

Coverages pertaining to the perils of earthquake or volcanic eruption can be purchased via an endorsement to a commercial property policy. Rates are often developed per dollar amount of insured exposure.

j. Lessor's Risk Insurance

Special rates for lessor's risk insurance are often applicable if the cannabis occupancy is more than a certain threshold of the property (e.g., more than 25%). Otherwise, the exposure is just rated on the standard policy. Rating appears to follow the approach used in insurers' standard lessors' risk programs. Cannabis factors are higher than for regular mercantile operations, ranging from +80% to +200% over standard mercantile rates. Categories include dispensaries, retail, medicinal, labs, product manufacturer, infused products, oil extraction and cultivation/grower. Additional schedule rating may apply to manual rates, with +/-25% maximum schedule-rated credits or debits.

k. Medical Professional Liability (Medical Malpractice) Insurance

Many traditional medical professional liability policies may exclude liability for recommended prescription of controlled substances. Accordingly, practitioners who prescribe medical cannabis to patients may seek special coverage limited to liability losses arising from prescription or failure to prescribe medical cannabis.¹⁰⁰ Coverage limits for such policies resemble those of traditional medical professional liability policies; the base limit is often \$1 million per occurrence/\$3 million annual aggregate. Rates are derived based on traditional medical professional liability policies in a given jurisdiction. Base-rate adjustments reflect a focus on claims arising from medical cannabis.

¹⁰⁰ California does not have prescriptions for cannabis, but a physician may recommend medical cannabis to patients. See https://www.mbc.ca.gov/Publications/guidelines_cannabis_recommendation.pdf. Accessed May 21, 2019.

Otherwise, classification plans may follow those filed for traditional medical professional liability insurance products.

An insurer's actuaries may estimate, often with historical data as a reference where available (although such historical data may be sparse), the proportion of medical cannabis-related losses to total medical professional liability losses and adjust the loss costs implied in the traditional medical professional liability policy rates accordingly. Afterward, the loss costs could be adjusted by a typically multiplicative load to reflect the insurer's expenses and targeted profit provision. It is possible that data related to frequency and severity of medication errors could be used as a proxy for data related to medical cannabis-related losses. This could result in a conservative estimate of loss costs because medication errors are a broader category.

I. Product Liability

The available programs for product liability insurance are often on a claims-made basis. Loss costs may vary between "producer" and "retail" classes. Producers include cultivators, growers and manufacturers, while the retail class includes distributors. Cultivator-only licensees receive a discount (sometimes substantial) from general producer rates.

Rating factors can relate to:

- Compliance with testing protocols.
- Operational maturity of the business.
- Management experience in the industry.
- Presence of a compliance officer.
- Compliance with packaging standards.
- Counterfeit products.
- Cleanliness of water supply.
- Location of suppliers.
- Use of petroleum gases during the extraction process.
- Existence of prior product recalls or regulatory infractions.
- Existence and quality of documentation of standard operating protocols.
- Whether the product needs to be applied topically or is vaporized.

m. Property Insurance

Premiums for property insurance may vary by type of covered property and the coverages purchased; e.g., building, business personal property, stock, business income/extra expense. Some insurers may require insureds who wish to purchase property coverage to also purchase general liability coverage. The insured may have an option to include or exclude coverage resulting from the peril of theft. Premium, including the minimum premium, may vary based on that selection.

Rates may be set proportionally to the insured value of the property. For plants before harvest, coverage limits may be set per plant and may vary based on the developmental stage of the plant; e.g., cloned/pre-vegetative, vegetative, pre-flowering, and flowering. For harvested plants, coverage limits may be set up to a fixed dollar amount per unit of weight (e.g., per pound). Coverage may also be available for the replacement cost of unplanted seeds. Additional property coverages may be purchased for: 1) money and securities; 2) accounts receivable; 3) personal effects; 4) valuable papers; 5) property of others; 6) signs; 7) tenant glass; 8) robbery and safe burglary; and 9) loss arising from employee dishonesty.

Loss costs for property coverages and related endorsements are often affected by the following considerations:

- Applicable limitations on territories where owned property is located; e.g., no out-of-state coverage.
- Ordinances/laws requiring cannabis businesses to make improvements to properties.
- Theft exclusions.
- Natural disasters, which could affect business interruption/loss of income coverages.
- Legal requirements applicable to tracking of inventory.
- Exposure to fungus.

n. Surety Bonds

The rating structure for surety bonds may use multiple tiers, determined based on such characteristics as commercial credit score, business experience, risk-management programs and prior regulatory actions. Rates may range between 2% to 10% of the bond amount, depending on tier. Additional schedule rating with variation up to +/-25% is available, with some insurers selecting a narrower range of variation in schedule-rated credits and debits.

C. Gaps in Coverage

Cannabis insurance is still relatively new to both the surplus and admitted market and the cannabis industry is constantly evolving and changing. With regulations and new laws being implemented at the federal, state, and local levels the way that the cannabis industry cultivates, manufactures, distributes, sells, and is consumed changes daily. The adequacy of coverage can change substantially in a short amount of time. For example, the price of cannabis can increase and decrease quickly and change for different regional areas. Therefore, a sufficient level of loss protection for the asset of cannabis will change. The quantitative measurement in the adequacy of coverage is in constant change especially with the cannabis industry evolving with innovation. For example, new strains of cannabis are being cultivated and new technology for vape pens for ease and increased consumption are emerging at a rapid pace. With new products emerging daily, it's difficult for insurers to not only assess the risk; but, also provide policies that meet the cannabis industry's needs. In addition, insurers are looking for data to determine the risk associated with cannabis to fill the gaps in coverage. But, with little to no data in areas such as drug-free workplace standard procedures or auto insurers impacted by the current inability to test for marijuana intoxication of drivers, insurers are finding it difficult to fulfill all insurance coverage needs in the cannabis industry. The lack of data creates an unknown which in turn creates gaps. It is difficult for insurance to keep up with the demands of such a burgeoning industry.

V. BEST PRACTICES AND RECOMMENDATIONS

A. EDUCATION, OUTREACH AND PUBLIC COMMUNICATION

Understanding the various facets of the cannabis industry is critical to learning about its insurance needs. Educational site visits to the different types of cannabis business operations (such as cultivation sites, manufacturing companies, distribution companies, testing labs and retail operations) should help state insurance regulators understand how the cannabis products are regulated on a state and local level. They will also assist in identifying where the areas of risk are decreased/increased throughout the supply chain.

Another educational avenue available to most regulators is reaching out to the cannabis industry trade associations, such as the National Cannabis Industry Association (NCIA), or a state trade association, such as the California Cannabis Industry Association (CCIA). Many of the cannabis trade associations have insurance subgroups that meet and discuss matters related to the topics of insurance availability, gaps and emerging trends in the cannabis insurance space. Reaching out to the trade associations is also a helpful

way to begin a dialogue about outreach to the cannabis industry regarding the importance of insurance and the presence of the state insurance regulator.

State insurance regulator participation in various outreach events is another option to learn more about the cannabis industry and teach the cannabis industry about insurance. Interacting with other state insurance regulators and stakeholders at conferences, workshops and meetings can also be beneficial. Doing so provides information on how the cannabis insurance intersects with other state insurance departments and entities, such as state cannabis licensing agencies. It also allows for more information on the various supply chain risks.

B. Dedicated Internal Infrastructure and Resources

State insurance departments should have a web page or outreach materials dedicated to providing information and answering commonly asked questions regarding cannabis insurance coverage. In addition to a web page, it is advisable to have an in-house subject-matter expert (SME) on the issue of cannabis insurance. This expert can help bridge the gaps between state insurance department staff, the cannabis industry and the insurance industry. At a minimum, each insurance department should have a point of contact to guide interested parties in reaching the appropriate department staff. Additionally, departments should identify an internal team across the department to ensure all critical players of the process are engaged and understand the various issues or goals. This also helps to streamline needed answers or resources to insurers interested in writing cannabis insurance.

C. Monitoring the Market and Gap Analysis

As the degree to which insurers are meeting the coverage needs of cannabis businesses continues to evolve, it would be useful for regulators and policy makers to have up to date information on the types of coverages available in each state and gaps in the market. State insurance departments could survey carriers and producers on the types of policies available in their state, and this information could be aggregated and posted on the NAIC website.

D. California's Path to Approving Admitted Carriers

California was the first state to approve admitted insurance carriers for cannabis-based businesses in the cannabis industry. Through education and outreach the California Department of Insurance (CDI) laid the groundwork for cannabis insurance on the admitted market. As of the publication of this white paper, the CDI had approved six

carriers. It launched the Cannabis Insurance Initiative (Initiative) in 2017 in anticipation of the insurance industry's role in the legalization of cannabis for adult recreational use, which took effect on January 1, 2018 with the passage of Proposition 64. The first phase of the Initiative focused on education and outreach in order to develop the CDI and insurers' understanding of the cannabis industry. The goal was to ensure the availability of insurance products for the cannabis industry by identifying challenges, opportunities, and solutions.

The CDI encouraged insurers to write on the admitted market by bringing them together in a meeting with leaders in the cannabis industry. The meeting focused on educating insurers about the cannabis industry and its insurance needs. The cannabis industry discussed issues they faced with finding and obtaining insurance. Insurers were able to ask questions and have an open discussion.

Subsequently, the insurer meeting participants were invited to a tour of an indoor grow, dispensary and manufacturing facility in San Jose, California. This allowed insurers to witness first-hand the sophistication, risk management, regulatory oversight, professionalism and transparency of the cannabis industry and the opportunities for the insurance industry. This further allowed the insurance industry to gain a better understanding of the cannabis industry and its insurance needs, while addressing questions and concerns.

The CDI continued educational efforts to bridge the gap between the cannabis and insurance industries on a larger stage by hosting a public hearing in Los Angeles, California in October 2017. The hearing was co-hosted by the California Cannabis Industry Association (CCIA) and the LA Cannabis Task Force. Hundreds of participants attended to hear cannabis businesses and the insurance industry provide their respective perspectives on cannabis insurance gaps. The public hearing revealed that while there was some insurance availability from surplus lines insurers, insurance was limited in scope and the California market would benefit from the entrance of admitted commercial carriers.

In addition to education and outreach efforts, CDI implemented operational procedures within the department to facilitate approval of admitted insurers for the cannabis industry. An in-house cannabis insurance SME was designated to lead the Initiative and serve as the primary point of contact to stakeholders. An internal cross-departmental team, which included rate filing and legal staff, also served respective roles to reach the goal of product availability. A website with key resources and contacts for the Initiative was launched. Through these resources, interested stakeholders and insurers can immediately identify

an entry point to the CDI on cannabis insurance, as well as educational materials and upcoming events.

These efforts by the CDI led to the filing and approval of the first admitted commercial insurance company to offer coverage to cannabis business owners in November 2017. This was just months away from the January 1, 2018 legalization of adult cannabis use. Golden Bear Insurance Company was the first insurance company in California to write insurance on the admitted market.

Since the first filing and approval, five additional admitted market insurance companies have followed suit. Additionally, in 2018, the American Association of Insurance Services (AAIS) designed the new Cannabis Business Owners Policy (CannaBOP) for cannabis dispensaries, storage facilities, processors, manufacturers, distributors, and other cannabis-related businesses operating in the state. CannaBOP is the first-of-its-kind standardized cannabis policy form that was approved by CDI.

E. Industry Trends and Policy Engagement

Given federal laws, such as the CSA and Banking Secrecy Act/Anti-Money Laundering Law, various industries (including insurance) are hesitant to engage in the cannabis supply chain. They fear exposure to criminal or civil liability. Policy changes at the federal level could play a critical role in encouraging more admitted insurers to write cannabis insurance.

Despite existing laws that may deter regulators, there has been an increase in federal legislative efforts to provide states greater regulatory authority over cannabis businesses without federal interference. Currently, the Rohrabacher-Blumenauer amendment, which prevents the DOJ from spending funds on prosecuting cannabis businesses in states that have medical cannabis laws, was extended through a federal spending bill.¹⁰¹ As mentioned above, the STATES Act, if passed, would allow states to regulate cannabis without federal interference.

However, as the cannabis industry continues to expand, there is a degree of uncertainty under President Trump and his administration. Former Attorney General Sessions had a longstanding public opposition toward the cannabis industry and actively removed

101. Angell, T., 2018. "Congressional Committee Protects Medical Marijuana from Jeff Sessions," accessed at www.forbes.com/sites/tomangell/2018/05/17/congressional-committee-protects-medical-marijuana-from-jeff-sessions/#546c1ca11e55.

protections. Recently appointed Attorney General Barr has indicated that he will not go after states that have legalized cannabis.¹⁰²

Many operators in the cannabis industry are willing to move forward despite these actions; but, such activities at the federal level also worried others outside of the cannabis space about the industry's stability. President Trump repudiated former Attorney General Sessions' rescission of the Cole Memorandum based on a request from U.S. Sen. Cory Gardner (R-CO), but the rescission nonetheless influenced business decisions such as offering insurance to the industry.¹⁰³ The change in the attorney general presents a new opportunity for the DOJ to clarify the administration's position on state-legalized cannabis. However, it is too soon to tell what Attorney General Barr's priorities will be with respect to the cannabis industry other than his public statements that he will not pursue state-legalized cannabis businesses.

With new regulations, rising consumer demands and the market landscape constantly changing, the cannabis business is booming and needs insurance protections in the cannabis industry. As such, state insurance regulators should follow the legislative landscape and impacts related to the cannabis industry. Policy changes at the federal level may influence the readiness of admitted insurers to write cannabis insurance. Thus, knowledge of the environment may guide insurance departments in their preparation for potential filings.

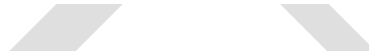
Collaboration with federal, state, and local entities may also serve to address barriers that prohibit access to insurance protection for cannabis business owners. With the deep knowledge of insurance issues, state insurance regulators can and should contribute their subject matter expertise and perspectives in these public policy discussions. Federal, state, and local entities may find it helpful to identify staff to address specific departmental and outreach needs. Additionally, state insurance regulators may sponsor legislation related to cannabis insurance. They may also further engage in policy-making by offering support for legislation addressing barriers.

102. Smith, A., 2018. "The U.S. Legal Cannabis Industry is Booming," accessed at <https://money.cnn.com/2018/01/31/news/cannabis-state-of-the-union/>.

103. Matthews, M.K., 2018. "President Trump to Cory Gardner: Colorado's Legal Marijuana Won't Be Targeted by Jeff Sessions, Justice Department," *The Denver Post*, accessed at www.denverpost.com/2018/04/13/trump-gardner-colorado-marijuana-industry-not-targeted/.

VI. CONCLUSIONS

As more states continue to legalize cannabis, the need and demand for cannabis insurance will only continue to increase. There are substantial gaps in insurance coverage for the cannabis industry, which means that consumers, workers, vendors, owners and investors face risks that are not covered as they interact or engage with the cannabis industry. It is important for state insurance regulators to understand and address insurance availability and coverage gaps in their markets. State insurance regulators who have encouraged insurers to cover the cannabis industry have been successful in getting more insurers to enter this market. State insurance regulators can play a critically important role in working with the insurance industry to encourage more insurance availability for the cannabis industry.



ADDITIONAL CANNABIS INFORMATIONAL RESOURCES

- Americans for Safe Access: <https://www.safeaccessnow.org/>
- Cannabis Business Times: <https://www.cannabisbusinesstimes.com/>
- Cannabis Now: <https://cannabisnow.com/>
- Drug Policy Alliance: <http://www.drugpolicy.org/>
- Global Commission on Drug Policy: <http://www.globalcommissionondrugs.org/>
- Law Enforcement Action Partnership: <https://lawenforcementactionpartnership.org/>
- Marijuana Policy Project (MPP): <https://www.mpp.org/>
- MJ Business Daily: <https://mjbizdaily.com/>
- National Cannabis Industry Association: <https://thecannabisindustry.org/>
- National Conference of State Legislatures: <http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx>
- National Organization for the Reform of Marijuana Laws: <https://norml.org/>
- Patients out of Time: <https://www.medicalcannabis.com/>
- Smart Approaches to Marijuana: <https://learnaboutsam.org/>
- Students for Sensible Drug Policy: <https://ssdp.org/>
- Transform Drug Policy Foundation: <https://transformdrugs.org/>
- Veterans for Cannabis: <http://www.vfcusa.com/>
- White House, Office of National Drug Control Policy- Marijuana: <https://www.whitehouse.gov/ondcp/key-issues/marijuana/>