

Cross-Border Cannabis Investment: Managing Money Laundering Risk

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Canada legalised recreational cannabis in October 2018 and it may be that other countries follow suit. UK and US investors, and those who facilitate investments in legal recreational cannabis businesses overseas, need to be aware of money laundering risks that arise and what they can do to protect themselves.

Why is this a money laundering issue?

In the UK, cannabis is a controlled drug and it remains unlawful to possess, produce, grow and sell cannabis for recreational purposes.¹ While it may be legal in Canada, funds generated due to investment in the recreational cannabis sector may be classified as proceeds of crime in the UK and dealing with them could therefore mean that a person or firm risks committing a substantive money laundering offence, or faces other regulatory consequences. In the United States, funds derived strictly from Canada's legal cannabis sector may not necessarily represent proceeds of crime, but there are sufficient risks for a US investor to be wary.

The substantive UK money laundering offences are contained in the Proceeds of Crime Act 2002 ("POCA").² Broadly, the money laundering offences under POCA make it a crime to deal with "criminal property".³ Criminal property is defined broadly as property that represents a person's benefit from criminal conduct, in circumstances where the alleged offender knows or suspects that it represents such a benefit.⁴ Criminal conduct is conduct that constitutes an offence in the UK or would constitute an offence in any part of the UK if it occurred there. For example, a public official in an overseas country may receive bribes in return for granting an oil concession, and ultimately use a portion of those funds to purchase a property in London. Those funds would represent criminal property and the public official would commit a money laundering offence in relation to that purchase by converting the cash into the real estate asset.

The production and sale of recreational cannabis is unlawful in the UK; the fact that the production and sale of recreational cannabis is legal in Canada is not of assistance regarding the UK regime.⁵ Therefore, investment in a Canadian cannabis business can fall within the UK's money laundering regime.

The situation in the US is much less straightforward. US criminal money laundering statutes are predicated on certain specified unlawful activity, which may or may not have extraterritorial reach, depending on how each

¹ See the Misuse of Drugs Act 1971.

² Sections 327 to 329 POCA.

³ Section 340 POCA.

⁴ The benefit can be in whole, or in part, or direct or indirect.

⁵ The substantive money laundering offences include a defence for those who knew or believed that the relevant criminal conduct occurred in a country where it was lawful and is not of a description prescribed by an order of the Secretary of State. This defence would not apply to the production and sale of recreational cannabis, because it is punishable by more than 12 months imprisonment in the UK - see Article 2 of the Proceeds of Crime Act 2002 (Money Laundering: Exceptions to Overseas Conduct Defence) Order 2006.

criminal statute is written.⁶ For example, one such specified unlawful activity is the manufacture, importation, sale, or distribution of a controlled substance, including cannabis. Ordinarily, a Canadian dispensary selling cannabis to a strictly domestic audience would not result in a violation of US law. However, US law also criminalises the manufacture or distribution of cannabis overseas if it is done so with the intent, knowledge, or reasonable cause to believe that the cannabis will be unlawfully imported into the US.⁷ Cannabis dispensaries along the US/Canada border may open themselves up to criminal liability if they do not have stringent controls governing sales to US residents. Persons knowingly engaging in financial transactions involving the proceeds of enterprises without such controls may also open themselves up to liability under US money laundering statutes.

How could a money laundering offence occur?

Investors could commit a substantive money laundering offence in a number of ways. For example, any dividends received by a UK investor could represent criminal property and the UK investor would be at risk of committing a substantive money laundering offence having acquired criminal property. US investors, however, would have to have some knowledge that such dividends were derived from an offence under US law before they risk criminal prosecution.

Investors are not the only ones at risk. Financial institutions and professional advisors that facilitate such a transaction, and that know or suspect the source of the payment, may also commit a substantive money laundering offence. Those in the regulated sector also have additional obligations to report knowledge and suspicions regarding money laundering.⁸

What can investors do to protect themselves?

If UK investors, or others, are concerned that they may commit a substantive money laundering offence relating to investing in overseas cannabis production or distribution, they can make a suspicious activity report (“SAR”) seeking consent to proceed from the National Crime Agency (“NCA”). If consent is granted, then the investor will have a defence to a substantive money laundering offence in relation to the relevant transaction.

In 2018, the NCA received 22,196 consent SARs and refused consent in relation to 1,291 (i.e. 5.7%) of those consent SARs.⁹ A refusal of consent is likely to occur when there is an ongoing investigation by law enforcement. It is difficult to imagine UK law enforcement investigating and prosecuting overseas investment in relation to the lawful production and sale of recreational cannabis in Canada. However, subject to future law reform, investors, particularly those who are regulated, should take legal advice and consider the need to file a SAR, as necessary.

US investors do not have a similar recourse. There is no safe harbour in the US for persons who knowingly engage in transactions involving criminal proceeds. While it is unlikely that the US Department of Justice will choose to prosecute investors in an industry that is legal under state or foreign laws, it maintains the discretion to do so where facts support a violation of US federal criminal law.

⁶ 18 USC. §§ 1956 and 1957

⁷ 21 USC. § 959

⁸ US financial institutions have an obligation to report suspected violations of laws or regulations under the Bank Secrecy Act (“BSA”). The Financial Crimes Enforcement Network, the administrator of the BSA, has published guidance regarding a financial institution’s suspicious activity reporting obligations related to the US cannabis sector (accessible [here](#)). In January 2018, FinCEN announced that such guidance was under review, but that it would still be applicable until it announces otherwise.

⁹ NCA, Suspicious Activity Reports – Annual Report 2018, page 3 (accessible [here](#))

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