Feature

KEY POINTS

- Fund managers and other investors run the risk of violating POCA, not from their initial investments, but from any revenues, including increased share price or profit from the sale of such assets, derived from cannabis enterprises.
- Financial institutions and professional advisors that facilitate such transactions and that know or suspect the source of the payment, may also commit a substantive money laundering offence.
- Money laundering offences would not be committed if an entity makes an "authorised disclosure" via a Suspicious Activity Report (SAR) to the National Crime Agency but investors, banks and other professionals would need to literally staff a full back-office of employees to file SARs given the hundreds of trades that occur over a single week.
- The author suggests the appointment of a neutral third-party monitor appointed by the court to provide oversight of legitimate overseas cannabis-related investments.

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Harvesting profit? Using independent monitors to help UK cannabis investors avoid money laundering charges

UK investment firms that wish to invest in the overseas cannabis industry face uncertainty regarding the legality of investing in a foreign company where cannabis is legal, running the risk of violating the Proceeds of Crime Act 2002. Financial institutions and professional advisors may also commit a money laundering offence. Use of independent monitors is proposed by the author as a solution.

GOLD FROM ALL THAT GREEN

This year, venture capital investment in recreational cannabis exceeded $1.3bn worldwide.[1] Medical cannabis investment in companies such as GW Pharmaceuticals (NASDAQ:GWPH) came in below that, but is expected to grow even larger by 2024. A report issued in late 2019 suggests that worldwide legal weed revenue will increase 853% to $103.9bn by 2024.[2] If your client is a fund manager, they are already thinking about the 45.6% compound annual growth rate this represents and are considering adding cannabis-related investments into client portfolios. The medical cannabis market in Europe is forecast to eclipse that of North America.[3] The recreational cannabis industry has its own ETF (THCX), and major brands such as Altria (who own the Marlboro brand) also hold a significant investment in a cannabis company. Constellation Brands, known for their Corona beer label, own marijuana company and brand Cronos. But it is not just the obvious cannabis product-producers' investors are keen on. Cannabis real estate investment trust (REIT), Innovative Industrial Properties (NYSE:IIPR) saw its stock rise this year, exceeding all forecasts, with revenue expected to top $80m;[4] cannabis technology companies such as those that help source and deliver marijuana edibles are receiving funding from Silicon Valley, raising tens of millions for companies such as LeafLink, Surterra Holdings, Eaze, and Green Bits; and cannabis sales management platforms receive backing from Evolv Ventures, 9Yards Capital, and Poseidon Asset Management. There are cannabis-specific funds such as Altitude Investment Management and Tuatara Capital who collect and trade millions. So, why are you not pleased when your London-based fund manager client calls to say they are seeing revenue come in from cannabis sector investments?

UK investment firms desiring to invest in the overseas cannabis industry face uncertainty regarding the legality of investing in a foreign company where cannabis is legal. In the UK, cannabis and synthetic cannabinoids are categorised as "Class B" drugs under Pt II, Sch 2 of the Misuse of Drugs Act 1971 (MDA)[5] and Proceeds of Crime Act 2002 (POCA)[6] and prohibit receiving, dealing with, or being concerned in a transaction that facilities the retention or movement of the proceeds of a crime. Dealing with proceeds from cannabis sector investments potentially could mean UK investors risk committing a substantive money laundering offence or could face other regulatory consequences. Fund managers and other investors run the risk of violating POCA, not from their initial investments, but from any revenues, including increased share price or profit from the sale of such assets, derived from cannabis enterprises.

POA'S COMPLEXITY

There has always been complexity under money laundering law where dealings involve conduct illegal in the UK, but not unlawful under the criminal law of a foreign jurisdiction. These types of cases or inconsistencies are referred to in the UK as "Spanish bullfighter" issues (based on bullfighting being legal in Spain, illegal in the UK, hence the proceeds of bullfighting being illegal in the UK). An exception from the application of the money laundering offences for legal conduct overseas was introduced by the Serious Organised Crime and Police Act 2005.[7] Whereas s 340 of POCA has the effect that predicate criminal conduct to which the money laundering offences apply can occur anywhere, the legal conduct overseas exception reverses that position *to a limited extent*. It has the effect of putting dealings with criminal

property or suspicions of money laundering beyond the reach of the money laundering offences where a person knows, or believes on reasonable grounds, that the relevant criminal conduct occurred in a country or territory outside the UK and:

- is not unlawful under the criminal law then applying in that country or territory; and
- is not of a description prescribed in an order made by the Secretary of State.

In 2006, the Secretary of State made such an order for the purposes of the principal money laundering offences in ss 327-329 of POCA. Order 2006/1070 (the Exceptions to Overseas Conduct Defence) (EOCD 2006)[8] has, in effect, narrowed the defences so that they are only available for dealings with property derived from criminal conduct which would amount to a *minor offence* under UK law. This would suggest an answer for our fund managers. Not so fast. The order provides a defence that is not available where the conduct in question, if it occurred in the UK, would be punishable by 12 months' imprisonment or more. By definition, the EOCD 2006 would not apply, as violations under the MDA 1971 are punishable in excess of 12 months' imprisonment.

Investments in cannabis companies, legitimate in their home countries (Canada, the US, Israel, Uruguay, etc) that are now traded on indices, wrapped into larger investment portfolios, included in diverse funds, and other financial vehicles means it is now possible that proceeds of such businesses could be regarded as "criminal property" under POCA. Any form of profit that develops from investments in entities involved in the production, sale or use of cannabis products, including ancillary services that cannabis monies pass through may therefore result in a UK investor breaching this country's anti-money laundering laws.

It is not difficult to imagine how monies invested in a fund could run afoul of the law. POCA s 327 would define the selling of shares by an existing shareholder in a cannabis company as constituting the transfer of criminal property, an offence. An investor opting to purchase shares in the listed cannabis company, under s 328 POCA would be engaging in arrangements that facilitate the acquisition of criminal property by another. Moreover, buying the shares would constitute the acquisition of criminal property (an offence under s 329 POCA).

Additionally, there are likely complicated questions about mixed funds in cases other than direct investments in a business that profits from (legally under local law) recreational cannabis. US investors would require some knowledge that such dividends were derived from an offence under US law before they risk criminal prosecution, whereas those in the UK can expect different treatment. Financial institutions and professional advisors that facilitate such transactions and know or suspect the source of the payment, may also commit a substantive money laundering offence. Those in the regulated sector have additional obligations to report knowledge and suspicions regarding money laundering. There would also be potential issues for banks and asset managers receiving or being involved in the movement of funds, or other property such as shares, from investors in or owners of cannabis-related businesses, or for overseas companies with investments in cannabis companies investing in the UK. Taken to its logical conclusion, the application of POCA could mean that if a large public company forming a diverse investment portfolio invests in a US/Canadian cannabis company or begins to trade cannabis-related products then all of its UK investors may have to divest their holdings or risk committing an offence.

Even UK entities which do not transact with those businesses, but, for example, receive funds by way of dividend or cash pooling from a Canadian company which does so, could be caught by POCA because they may receive or deal with monies which are arguably tainted (the concept of fungibility means that even a small amount of criminal property can taint a wider asset, for example money in a bank account).

THE CASE LAW THUS FAR

Much ink has been expended on a handful of cases in English courts in an effort to "read the weed leaves" and identify affirmative defences for those who unwittingly invest in cannabis. The meaning of criminal property was scrutinised in cases such as *R v Loizou* [2004] EWCA Crim 1579, *R v Geary* [2010] EWCA Crim 1925 (in respect of s 327 and s 328 offences respectively) and *GH* [2015] 1 WLR 2126. The conclusion in these cases – albeit only in *obiter* comments in *Loizou* – is that property must be criminal property *at the time* the alleged criminal activity was undertaken. This has had the effect that individuals who invest in companies having no connection to the cannabis industry but subsequently change their business to include cannabis-related activity will not commit an offence until they begin to receive proceeds generated by that activity. Merely holding the shares would not constitute an offence.

Section 329(2)(c) POCA also contains a specific defence to the offence of acquiring, using or possessing criminal property, which is that a person does not commit an offence if they acquired their property for "adequate consideration". Consideration would be "inadequate" for these purposes if it was significantly less than the value of the relevant property. Therefore, shares purchased in a public company for market value would not count as criminal property. The right to benefits derived from those shares – such as dividends and capital growth – should also be considered to have been purchased for adequate consideration. Investors, don't get excited, this has not yet been tested in England's courts.

PRE-EMPTIVE SAR FILINGS

POCA does offer a form of affirmative defence, specifying a method to ensure that the various money laundering offences are not committed under the relevant sections[9] provided an entity makes an "authorised disclosure" via a Suspicious Activity Report to the National Crime Agency (NCA) regarding the relevant act and receives direction from the NCA as to how to proceed.

Taken to its logical extreme, lacking any other option, investors, bankers and other professionals who in some way touch gains or revenues generated from investments in cannabis-related entities, would need to staff a full back-office of employees whose sole responsibilities would be the filing of defence requests[10] SARs and subsequently tracking the NCA's response to each individual filing. Whilst such an approach may provide a marginal level of comfort to investment firm compliance officers, it would be but a brief panacea. Imagine the volume of filings from one active trading company or fund manager with daily shifts buying and selling within multiple portfolios. The NCA has up to six days to respond to any one proactive SAR filing. Hundreds of trades may have occurred over a single week's period, so that by the time the response on the seventh working day arrives, proceeds from a cannabis company investment, even one that comprised the most minor percentage of an investment fund, would already have been received, possibly reinvested into something else, resulting in potentially multiple violations involving money laundering.

The staffing levels required to manage an investment firm's SAR filings would be substantive. A myriad of potential pitfalls suggest so themselves: the volume of trading and downstream investment partners could result in some SAR's for acquisitions or trades not being filed in a timely manner; if an NCA response to a SAR is a "no", the investment house would need to notify investors and either prevent a trade from completing or attempt to claw-back (unlikely) the transaction so as to avoid violating the prohibition; and SAR staff would still have to be notified of a trade or potential trade to complete an advance SAR filing, posing a significant logistical challenge in high-speed trading environments. Now imagine what would happen if after an initial purchase of shares in a cannabis entity, the share price drops during the time between the SAR filing and the NCA's response. No revenue has been generated, rather it is a loss and the firm has expended energy on what for the time-being has become an unnecessary filing.

For some smaller fund managers or direct investment groups, such an approach may be just barely achievable. This of course assumes the investors possess a clear understanding of the types of investments that need to be reported to the NCA. This would require training of both the investment and compliance sides of the house. If fund managers are challenged from their side, imagine the volume of SARs pouring into the NCA. In all likelihood, were the investment and banking community to adopt this approach in full, the NCA would be swiftly overwhelmed.

Were investment houses and fund managers to shift the burden, they could demand that investors themselves file the required pro-active SARs with the NCA, in anticipation of a direction to their fund managers to include in their portfolio the specific cannabis investments. It is fairly easy to identify where imposing such requirements would clearly stumble. Oft times, investors establish no more than their risk appetite, leaving the specific stocks or investments in the hands of their managers. Financial advisors, banks and investment houses would be relying upon their clients to file paperwork for a compliance burden that affects them directly. Relying on each investor to be responsible for their own regulatory obligations creates a significant risk for firms and it is questionable if such an approach would be sanctioned by Legal or Compliance of said entities. The risk of exposure to potential regulatory violations if an investor failed or fell behind in their SAR reporting would be too great. To adhere to the SAR regime an investor would technically have to submit a SAR each time they decided to take an action in respect of their "criminal property" – such as purchasing shares, receiving dividends or selling their shares.

DIFFICULTIES FOR INVESTORS

Avoiding making investments which have some connection to foreign cannabis industry entities would be the obvious way to avoid a POCA breach, but this is easier said than done – there is no SDN (Specially Designated Nationals) or Blocked Persons List against which potential investments can be screened as they can for sanctions or watch lists. This means firms being alive to potential links to the overseas cannabis industry and performing due diligence to determine if any links can be found (which may involve diligence at a level below that of the investment company given that an investment in a company higher up on the chain to that with cannabis industry links may also fall foul of POCA). If the client is also a US investor, it is important to note there is no safe harbour in the US for persons who knowingly engage in transactions involving criminal proceeds. Similarly, if the client was convicted of laundering in the US or UK, and they had business operations in both countries, the likelihood of prosecution for money-laundering in the other jurisdiction would rise.

In June 2019, the Law Commission published a report[11] on the SARs regime. Among the Commission's recommendations was a call for the government to consider the need for guidance in relation to transactions involving the legal cannabis industry in Canada and elsewhere.[12]

ENTER THE INDEPENDENT MONITOR

Until legislation addresses investments in the legal cannabis industry outside of the UK, there is an urgent need for an alternative approach that may allow investments to proceed whilst mitigating the risk of inadvertent POCA violations. Court-appointed receivers, prosecutorial-appointed criminal asset recovery managers, and even court-appointed experts in judicial proceedings[13] provide a template for allowing the appointment of neutral third-party monitors to provide oversight of legitimate overseas cannabis-related investments. As observed in *Barnes (As Former Court Appointed Receiver) v The Eastenders Group and Another* referencing POCA:

> "Sections 40 to 49 make provision for protective measures by way of restraint orders and receivership orders in order to preserve the realisable assets of a defendant or prospective defendant against whom there is a reasonable

likelihood of a confiscation order being made'" [14]

Revenue from cannabis investments, including increases in share values, would be realisable property[15] under POCA definitions. As established in *Crown Prosecution Service v Compton*,[16] it is sufficient that "on the documents" an arguable case arises for treating the relevant assets as the realisable property of the defendant. As the appointment of a management receiver by a court is by its very nature an interim measure before any criminal proceedings have been determined, and under POCA s 48 the court need not have made a final determination to make the appointment, conceptually a monitor appointed by the court could hold any profits derived from cannabis investments a fund manager or other financial entity earned, separate and apart from the entity's other assets.

It is even conceivable that a fund manager or similar entity could file notice with the NCA that it anticipates profits will be generated from cannabis investments held as part of a larger financial portfolio. In turn, the NCA would file an *ex parte* application with the Court seeking the appointment of an independent monitor to provide control and oversight of resulting funds from the filing entity.[17]

An appointed monitor would then be responsible for identifying all cannabis-related investments; tracking and isolation of any profits or proceeds emanating from those investments; and the ring-fencing of resulting monies or value, in order to remove the possibility of inadvertent co-mingling with other investment proceeds or funds. Further investments in cannabis-related vehicles would not be precluded by the entity being monitored, but profits from cannabis investments could not be re-invested but would need to be held in the monitored account. This anticipates, sometime over the next few years, the legalisation of legitimate foreign cannabis investments.

An independent third-party monitor would be able to identify investments connected to cannabis revenue. Once identified the third-party monitor could segregate those investments and confirm that the proceeds are not comingled with other investment revenue. Any revenues derived, or interest earned, would need to be placed in a special fund. For example: if a stock or holding went up in value, it would need to be placed in the fund. This can become complicated for large investment firms that regularly conduct trading in large volumes, because the connection to the cannabis industry is very broad. Like a neutral trustee in a bankruptcy or asset forfeiture proceeding, a third-party monitor would assume responsibility ensuring realisable property in the form of cannabis investment assets do not violate POCA.

Unlike most receivers appointed under UK criminal proceedings, the investment company could pay the fees of the agreed monitor, and such an imposition would likely not fall afoul of the proportionality test established in *Lithgow v United Kingdom*,[18] as in this new and unique circumstance, the monitor would serve an equally valuable role to the fund manager or FI as to the regulator. The complete independence of the monitor would bring the required oversight providing assurances to the NCA and CPS that proceeds derived from statutorily-prohibited conduct such as cannabis investments in legal jurisdictions are not freely circulating, whilst giving comfort to fund management companies, banks and others who handle financial vehicles that may benefit from said investments that the profits potentially earned are not going to be forfeited or lost, but safely set aside. POCA s 49 allows a court to confer upon a receiver powers related to the relisable property that includes the power to take possession of the property;[19] manage the property[20] and hold the property[21] and take any other steps the court thinks appropriate.[22]

It is also conceivable that the Ministry of Justice could establish a separate unit under the current Asset Confiscation Enforcement (ACE) Teams dedicated solely to foreign cannabis investments. As such, this specialised asset management office would draft the necessary orders and appoint or approve the necessary independent monitors. Obviously, safeguards would be required so that investment and financial firms seeking to do the right thing and comply with UK law were not erroneously labeled criminal enterprises under POCA when the NCA files a request with a court for the imposition of a monitor for said company. However, using the law as it stands which allows the government to take any action necessary, such as an application for a writ of entry in any civil or criminal forfeiture case, to preserve the availability of property *subject to forfeiture*, including the imposition of a monitor or receiver, may provide the temporary solution sought.

Whilst additional guidance from the government as to how UK investors can navigate investing in the overseas cannabis industry is awaited and legislation is not as yet drafted, independent monitors offer a viable and satisfactory alternative solution to investors' profits going up in smoke. ■

1 'Venture capital pot investments jump to $1.3bn in 2019', *Financial Times*, (London, 11 June 2019), https://www.ft.com/content/e1e3a31e-8c83-11e9-a24d-b42f641eca37.

2 Sean Williams, 'Worldwide Cannabis Sales to Grow 853% by 2024, New Report Estimates This lofty growth forecast isn't even one of the five most surprising stats or predictions in the report' (*The Motley Fool.com*, 9 Nov 2019), https://www.fool.com/investing/2019/11/09/worldwide-cannabis-sales-to-grow-853-by-2024-new-r.aspx last accessed 6 December 2019.

3 *Id.*

4 Sean Williams, 'Surprise! 3 Pot Stocks With Rising Sales Estimates: Despite plunging revenue projections throughout the marijuana industry, these cannabis stocks are bucking that trend' (*TheMotleyFool.com*, 12 Nov 2019), https://www.fool.com/investing/2019/11/12/surprise-3-pot-stocks-with-rising-sales-estimates.aspx last accessed 6 December 2019.

5 The Misuse of Drugs Act 1971, c. 38.

6 The Proceeds of Crime Act 2002, c. 29.

7 Serious Organised Crime and Police Act 2005, c. 15.

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8 Proceeds of Crime Act 2002 (Money Laundering: Exceptions to Overseas Conduct Defence) Order, SI No 2006/1070.

9 POCA ss 327(2)-329(2).

10 National Crime Agency, UK Financial Intelligence Unit, *Requesting a defence from the NCA under POCA and TACT*, (May 2019, Ver. 5).

11 Law Commission, Anti-money laundering: the SARs regime (Law Com No 384, 2019).

12 *Id.*, paras 11.54-11.59.

13 European Commission for the Efficiency of Justice (CEPEJ), Guidelines on the role of court-appointed experts in judicial proceedings of Council of Europe's Member States, (Strasbourg, 12 December 2014) CEPEJ (2014)14.

14 *Barnes (As Former Court Appointed Receiver) v The Eastenders Group and Another* [2014] UKSC 26, [2014] WLR(D) 194, [2014] 2 WLR 1269, UKSC 2013/0006, at 30.

15 Realisable property being defined under POCA, s 83 as "any free property held by the defendant and any free property held by the recipient of a tainted gift. The term 'property' is defined in s 84 and covers all property wherever situated and includes money, real or personal property, a thing in action, or other intangible or incorporeal property. A person 'holds' property if he holds an interest in it. A person obtains property if he obtains an interest in it, and one person transfers property to another, if the first one transfers or grants an interest in it to the second. References to an interest, in relation to property other than land, include references to a right (including a right to possession)."

16 [2002] EWCA Civ 172.

17 Part 33.56(6) CrPR 2015 requires that, unless the application to appoint the receiver is made *ex parte*, an application for the appointment of a receiver (or monitor in this case) and any witness statement must be lodged with the Crown Court and served on the defendant (the investing entity here), any person who holds realisable property to which the application relates, and any other person whom the applicant knows to be affected by the application at least seven days before the date fixed by the court for hearing the application, unless the Crown Court specifies a shorter period. The attendant witness statement requires the basis for the application, details of the proposed receiver and, to the best of the witness's ability, full details of the realisable property in respect of which the applicant is seeking the order and must specify the person holding that realisable property.

18 (1986) EHRR 329, paras 121 to 151.

19 POCA, s 49(1)(a).

20 *Id.* 49(1)(b).

21 *Id.* 49 (4)(a).

22 *Id.* at (f).

Further Reading:

- Reforming the SARs Regime: questions of practice and legal principle (2019) 9 JIBFL 608.
- Can a customer speed up the process of removing a freeze on its account? (2019) 4 JIBFL 236.
- LexisPSL: Life Sciences: News: Exploring the impact of the legalisation of cannabis-based medicinal products.