AmWINS Group, Inc.

FROM SEED TO SALE: THE TOP 5 ISSUES IMPACTING THE CANNABIS INSURANCE INDUSTRY

The legal cannabis industry has experienced rapid growth over the last few years and has had a significant impact on the United States economy. In 2018, the cannabis industry reached over $10.4 billion in sales and is projected to reach $22 billion by 2022. The number of jobs directly related to the industry reached 211,000 in 2018, and with over 64,000 new jobs added, it is one of the fastest growing job markets in the country.[1] Cannabis is currently legal for medicinal use in 33 states (and D.C.) and for recreational use in 11 states (and D.C.)[2] With the cannabis market booming and states continuing to legalize its use, insurance needs for these businesses are becoming a significant topic of discussion.

Despite being legal in many states, cannabis is considered a Schedule 1 substance by the United States Drug Enforcement Administration. Insurance carriers have been slow to enter the cannabis sector due to the drug's illegal status federally and the very limited data on health impacts, loss trends and milestone claims needed by underwriters to accurately understand and price the risks. A.M. Best reported that insurers who have entered the cannabis space remain cautious, only offering basic policies with limits that may be inadequate for larger marijuana business owners.

Cannabis businesses are also unable to find coverage through the London market, as Lloyd's prohibits writing cannabis risks in the United States due to federal banking regulations. However, since Canada passed national legislation in October 2018 making all cannabis and hemp products legal, many Lloyd's syndicates and underwriters are actively writing various coverage lines on Canadian cannabis accounts.

This article will examine five of the most significant issues impacting insurance coverage for the cannabis industry in today's market.

1. FINANCIAL INSTITUTIONS ARE SUBJECT TO FEDERAL CRIMINAL LAWS

Since cannabis is illegal at the federal level under the Controlled Substances Act, financial institutions are subject to criminal prosecution for their involvement with cannabis-related businesses. For some states that have legalized cannabis, there are community banks and credit unions that are willing to provide banking services. However, to protect themselves from legal repercussions, many financial institutions remain hesitant or unwilling to work with cannabis-related accounts. This has forced numerous cannabis-related businesses to operate on a cash-only basis, making it difficult for those companies to engage in standard business practices such as paying employees and taxes.

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The Bank Secrecy Act, Money Laundering Statute and Unlicensed Money Transmitter Statute are the three primary federal criminal laws that can be triggered when institutions engage in transactions involving cannabis or proceeds from the sales. Violations to these laws can result in serious fines (up to $500,000) and jail time.

A potential resolution may be on the horizon. In March 2019, the House Financial Services Committee voted in favor of advancing H.R. 1595, the Secure and Fair Enforcement (SAFE) Banking Act. The proposed legislation would provide the following benefits:

- Prevent federal banking regulators from punishing banks that work with cannabis-related businesses
- Protect ancillary businesses that work with the cannabis industry from being charged with money laundering and other financial crimes
- Require the Financial Institution Examination Council to develop guidance to help credit unions and banks understand how to lawfully serve cannabis businesses[3]

Update: On September 25, 2019, the House of Representatives passed the SAFE Banking Act by a vote of 321 to 103.[4] Before becoming law, the legislation still needs to be voted on by the Senate and signed by the President.

2. CRIME PREVENTION AND SECURITY PROGRAMS

Since many cannabis-related businesses, such as dispensaries, operate using paper currency, crime is a significant part of their risk exposure. These businesses also house a large amount of product that can be stolen and sold on the black market for a substantial amount of money. This high potential for crime puts employees and patrons at risk for injury if a robbery should occur.

Despite the substantial risk of crime, many carriers will exclude Assault & Battery or sublimit the coverage. As a result, a business' location and its security features are important factors to be aware of when looking to place coverage.

While the crime score of a location can impact its ability to secure coverage, even retailers with insureds in safer areas should still review the policy to ensure Assault & Battery is not excluded.

Insurers will often review the due diligence measures and sophistication of security programs employed by a business to prevent crime. For retail dispensary shops, this can include ID checks, personal shoppers that monitor a patron's activity, a limit to the number of customers allowed in each room at a time, and surveillance cameras. For cultivation facilities and processors, third-parties are typically brought in to handle security. Their services can include armed security with automatic rifles, trained dogs, and armed car service for transportation of product. Businesses with robust risk management programs can see a reduction in rates and more coverage options.

3. THE LEGALITY OF HEMP AND CBD UNDER THE FARM BILL

With passage of the Farm Bill in 2018, the United States Congress has legalized the cultivation of hemp and, if produced in a manner consistent with the law, removed restrictions on the sale, transport, and possession of hemp products. Under this bill, hemp is defined as the cannabis plant with one important difference: hemp cannot contain more than 0.3 percent of THC, the chemical responsible for most of cannabis' mind-altering effects. Cannabinoids (or CBD) are a set of chemical compounds found in the cannabis plant. Under the Farm Bill, any CBD product derived from hemp is considered legal if produced in a manner consistent with the legislation.[5]

Since hemp and CBD are now legal, their coverage must be separated out from other cannabis risks. With its legalization still relatively new, hemp and CBD insurance placements remain solely in the E&S market. There are insurance products available on the casualty side, but it may take some time before these risks are available in the standard market or in a farm liability package.

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4. NEW EXPOSURE FROM VAPE PENS AND E-CIGARETTES

Cannabis risks and exposures have expanded beyond traditional smoking. Vape pens and e-cigarettes are becoming users' preferred method of consumption due to their convenience and reduced smoke inhalation. Businesses throughout the cannabis supply chain, including cultivators, processors, distributors, and retailers, face exposure from vape products in the event that a defect results in injury or a label fails to include proper warnings. For example, processors that put cannabis into oil form, which is then placed in the vape pen's capsule, could be pulled into litigation if a claim occurs.

There have been several losses resulting from fatalities due to exploding batteries in vape pens. Most of the incidents can be traced back to five Chinese battery manufacturers. Any vape pen that utilizes these manufacturers will be excluded from coverage by nearly all carriers, making it pertinent to know where all parts are coming from in order to avoid these facilities

Due to these risks, very few insurance carriers are willing to cover vape products, and those that do offer coverage charge a separate rate for vape and accessory exposure. The difficult nature of securing this coverage has caused many businesses to modify their offering or self-insure.

Throughout the summer of 2019, there have been nearly 200 cases of vaping-related respiratory illnesses reported by doctors and hospitals in 22 states, with one incident claiming the life of a patient in Illinois. While the exact causes of the illnesses are unknown, many of the patients acknowledged vaping cannabis' high-inducing chemical, THC.[6] This development may further complicate insuring vape products in the future.

5. COVERAGE CONCERNS THROUGHOUT THE SUPPLY CHAIN

From seed to sale, businesses throughout the cannabis supply chain have specific risks and coverage needs. Below are the top risks, coverages and gaps to look out for when handling cannabis-related accounts.

- Cultivation
  - Two important coverages for cultivators are Goods in Process (coverage for damage to growing crops) and Finished Stock, (coverage for crops still in the insured's possession that have been harvested, budded, and cultivated and are ready to move to the next phase of production.) While many carriers will exclude these coverages, both can be found if desired. It is important for agents to note that these coverages will be sub-limited.
  - Outdoor Crop Coverage, typically an exposure for hemp crops, has proven to be the most difficult coverage to place within the cannabis and hemp/CBD space. Carriers offering this coverage are scarce and those willing to offer coverage charge a much higher rate.
  - To accurately determine the limits needed, valuation of the outdoor crop is an important step that requires a detailed understanding of the crops being grown, including the yield per acre, total number of acres, and the growth phase used to calculate value.

- Manufacturing
  - Extractors often combine many sources of raw products, which creates the risk for cross-contamination and products liability exposure. One bad ingredient, whose source may not be identifiable, could ruin an entire batch of product, causing a loss in product value and production time, bodily injury, recall and/or reputational damage.
  - Carriers are beginning to amend the Health Hazard Exclusion to allow for Sudden and Accidental coverage, which is a carve back for bodily injury claims that occur at single point in time.

- Testing Labs
  - In response to the growing market, testing labs are now actively seeking Professional Liability protection. This is not only pursued in compliance with the Farm Bill's 0.3 percent THC limit for hemp and CBD products, but also in legalized states where cannabis itself is evaluated for potency and quality, among other criteria.

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- Distribution
  - For cannabis risks, there are no master multi-state policies. Separate policies are required for each state.
  - When cannabis products are in transport, many businesses do not have proper risk management controls in place. If companies are transporting a significant amount of product, an armed car service should be considered, as well as coverage for stock in transit.

- Retail
  - While dispensaries often employ pharmacists and physicians for licensing purposes, a common gap in Medical Professional Liability exposure exists when these roles are limited solely to medical director or healthcare consultant services. Currently, the two primary areas for which dispensaries obtain Professional Liability coverage are: (1) licensed pharmacists dispensing the cannabis products for said dispensaries and, (2) licensed medical directors providing referral cards. While the market is extremely limited in this sector, Professional Liability continues to evolve as enterprising carriers begin to consider emerging risks.
  - An emerging coverage solution, known as Budtenders E&O, provides protection to clerks at the cannabis dispensary who provide consumers with advice or recommendations on specific products. As Budtenders E&O was designed to fill the potential gaps within Product Liability policies, this is primarily added as an endorsement within GL, despite the increasing demand for a stand-alone policy.
  - As discussed in the Crime section of this article, Assault and Battery is a significant exposure at cannabis-related businesses. However, carriers often exclude this coverage from policies.
  - As with any business, General Liability coverage and the potential for Slip & Fall claims should not be overlooked when protecting the company's premises and operations. However, standard General Liability policies exclude Schedule 1 substances from coverage, which make it difficult to obtain adequate coverage.

CONCLUSION

The cannabis industry is evolving daily as a result of emerging concerns and new ways to look at coverage forms. With cannabis-related health research just beginning to be conducted and loss data and claims examples still in their infancy, coverage in the cannabis space remains almost exclusively in the E&S marketplace. While there are program solutions available for cannabis-related businesses in the market today, most have insufficient coverage and gaps that leave the insured exposed. Many carriers that have entered the space choose to work with distribution partners that have a strong understanding of the cannabis industry and needs of the related businesses.[7]

AmWINS has specialist brokers across the United States and in London who are well-versed in the current issues in the cannabis and hemp/CBD space. This expertise allows us to guide our retail clients through the placement process and help them understand all lines of coverage needed to build a comprehensive risk management and insurance program for their insureds.

ABOUT THE AUTHORS

The following AmWINS specialists contributed to this article.

- TJ Collins – Vice President, Casualty, AmWINS Brokerage in Kansas City, MO
- Matt Jarrett – Director, Casualty, THB London
- Ryan Schaller – Associate Brokerage, Property, AmWINS Brokerage in San Francisco, CA
- Charlie Grodecki – Vice President, Professional Lines, AmWINS Brokerage in Charlotte, NC
- Jeff Katz – Vice President, Property, AmWINS Brokerage in Kansas City, MO

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