WHITE PAPER

The Jencap Insurance Industry Outlook:

PREPARING FOR THE FUTURE OF CANNABIS INSURANCE

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INTRODUCTION

The cannabis industry in the United States is blossoming (pun intended). California paved the way for state-level legalization of medical cannabis in 1996, and a handful of other states followed several years behind. Sixteen years later, Washington and Colorado took things a step further by legalizing cannabis for recreational use. Now, as of spring 2023, 40 states and D.C. have some sort of legalized framework for cannabis products—either medical, recreational, or both.

Over the past few decades, public opinion and perception toward cannabis has shifted dramatically. According to Pew Research Center, as of 2022, an overwhelming **88% of U.S. adults are in favor of legalization,** with 30% in support of medical-only use and 59% in support of medical *and* recreational use.

Current cannabis sales reflect that positive sentiment; as a whole, the industry is **on track to reach sales of $33.6 Billion by the end of 2023** and up to $56.9 Billion in five years' time.

CANNABIS REMAINS FEDERALLY ILLEGAL

Despite national approval and state-level support, cannabis remains federally illegal for production and sale. While this is the case, cannabis operations have limited access and options for banking, investor funding, credit card processing, tax relief, and insurance.

In a sense, the federal government has chosen to "look the other way" and allow individual states to manage and regulate their local cannabis industries on their own. As a result, each state has its own brand of cannabis regulation. Different states have different rules for businesses when it comes to how much cannabis they can sell, where and how they can dispense products, how they have to track and trace their products, and how much insurance they must carry to maintain their operating license.

It's only a matter of time, however, until all this will change.

FEDERAL CANNABIS REFORM IS INEVITABLE

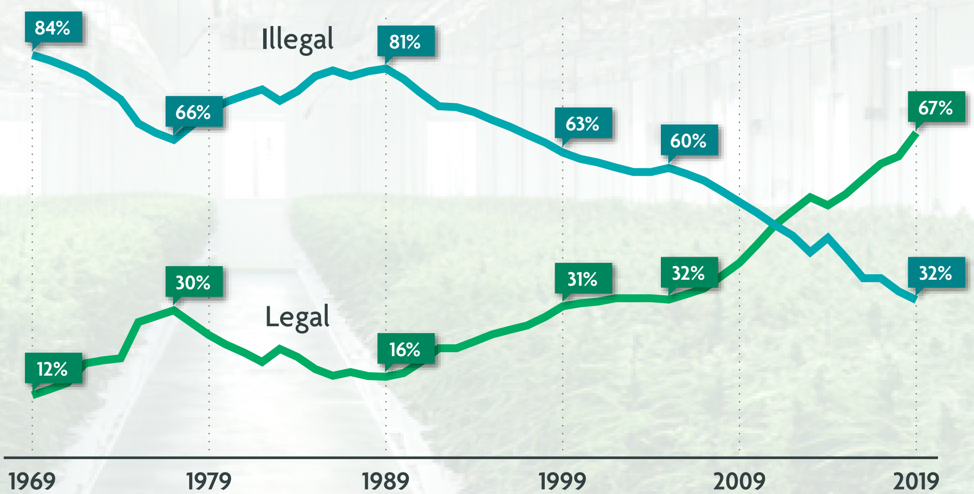
At some point in the future—whether that's in three years, five years, or ten years, the federal government will make a move to change cannabis legislation. It's anyone's best guess for what that will look like. As insurance professionals, it's imperative that we think through all possible scenarios and diligently prepare ourselves and our clients for what the future of cannabis may bring.

We invite you to take a journey with us down the paths of three possible future scenarios.

In each scenario, we'll jump five years into the future and take a peek into what the world *could* look like and how that might impact cannabis operations and the cannabis insurance landscape.

U.S. Public Opinion on Legalizing Marijuana, 1969–2019

Do you think the use of marijuana should be made legal, or not?



Note: No answer responses not shown. 2019 data from Pew Research Center's online American Trends Panel; prior data from telephone surveys. Data from 1969–1972 from Gallup; data from 1973–2008 from General Social Surveys.

Source: Survey of U.S. adults conducted Sept. 3–15, 2019. PEW RESEARCH CENTER

It's the year 2028. . .

CANNABIS IS DECRIMINALIZED

SCENARIO 1

Sarah is the owner of Sarah's Green Boutique, a dispensary in Oregon. She opened her first medical dispensary in 2014 and expanded her business to offer recreational products the following year. She's worked diligently to build community support and develop strong relationships with local cannabis farms and product manufacturers. As a result, her business has thrived, and over the years, she's opened two more locations in the state.

Decriminalizing cannabis would remove a lot of the fear and stigma associated with cannabis and break down boundaries in a way that would allow the industry to prosper more within the confines of state regulation.

—Jodi Green, Counsel, Feldman Legal Advisors

DECRIMINALIZATION DOESN'T MEAN LEGALIZATION

When Sarah entered the cannabis business over a decade ago, just a handful of states had legalized the sale of cannabis, and public perception of cannabis was wary at best. Now, in 2028, the majority of states have legalized cannabis for either medical use, recreational use, or both, and the federal government recently passed legislation decriminalizing cannabis.

Despite this progress, Sarah—and other cannabis business owners like her—are frustrated. With decriminalization, possessing and using cannabis is no longer a criminal offense, but it still remains federally illegal, which hampers legitimate businesses like Sarah's Green Boutique.

INTERSTATE COMMERCE AND BUSINESS FUNDING REMAIN A CHALLENGE

Sarah's Green Boutique has flourished, and Sarah has ambitions to expand into neighboring states. However, due to federal restrictions and differences between individual states' legislations, it's tricky for a business to operate in multiple states. Cannabis grown in one legal state can't be transported to another and every state has different regulations around what can be sold, how, and in what amounts.

Larger multistate operators (MSOs) have gotten around these restrictions by opening legally-distinct business entities in different states. This allows them to sell products in multiple states under the same brand name while complying with individual state regulations.

But a large operation like this feels out of reach for a smaller-scale business owner like Sarah, who has struggled to secure capital. Because cannabis operations are still technically illegal according to the federal government, many banks and traditional investors just aren't willing to risk doing business with her.

DECRIMINALIZATION ALONE WON'T SIGNIFICANTLY IMPACT INSURANCE

Securing comprehensive and reasonably priced insurance for her business is also challenging for Sarah. Compared to when Sarah first opened up shop, there are a lot more options, but it's limited to a handful of carriers with tight restrictions and limited coverage.

> *If decriminalization does lead to more cannabis business locations and more sales, then we can expect to see an expansion of insurance capacity and a desire for excess liability coverage; especially for auto, workers compensation, and general liability products. I'd also expect to see more insurance markets, and they'll have to compete either on price or coverage. It will create a more competitive insurance environment, which will benefit insureds, first and foremost.*
>
> **—Erich Schutz, Jencap Vice President, Cannabis Practice**

Technically, since it's still not legal, the federal government could prosecute insurers who provide coverage to cannabis businesses. As a result, most carriers—especially those in the admitted markets—aren't willing to work with cannabis operations.

Although decriminalization won't automatically prompt admitted markets to join the cannabis game, additional legislation might. If the Clarifying Law Around Insurance of Marijuana (CLAIM) Act, for instance, were pushed through, we'd quickly see a shift in the insurance market. The CLAIM Act, first introduced in March 2021, would allow insurers to offer coverage to cannabis businesses in legalized states, without the threat of federal prosecution.

MORE SPECIALTY INSURERS ENTER THE SPACE

Although the more mainstreet insurers remain wary, there are specialty carriers who see the growing cannabis industry as an area of opportunity. As more states create their own cannabis legislation, new cannabis businesses will begin popping up, and existing MSO operators will attempt to gobble up the expanding market share. When they do, cutting-edge insurers will be there to serve the need. Coverage, however, will come at a significantly higher cost than what's available to traditional businesses.

MANY OF THE SAME RISKS REMAIN

Although Sarah's Green Boutique is likely to find some kind of coverage somewhere, they pay much higher premiums than the average business and they face tight underwriting guidelines.

All businesses are at risk for things like product defects or mislabeling, theft, and workplace accidents. For cannabis businesses like Sarah's Green Boutique, however, these risks can look a bit different. There's always a chance that a customer may have a bad reaction to a product Sarah offers. Even worse, Sarah could unknowingly sell a product that is contaminated and makes the customer sick. In cases like these, the customer could sue, and Sarah's Green Boutique could be held liable for medical expenses and costly legal fees.

Most cannabis businesses don't have traditional credit card functionality because banks and financial institutions are reluctant to work with cannabis operations. As a result, Sarah and other cannabis operators keep more cash on hand than a typical business, putting Sarah's Green Boutique at a greater risk of theft and increased liability.

THE INDUSTRY REMAINS OPTIMISTIC

The good news for Sarah and her business is that as more specialty insurers continue to enter the cannabis space, capacity will also continue to increase and the competition will begin to nudge down premiums.

> *If cannabis is federally decriminalized, you can expect to see a lot more chatter among carriers about potential product offerings. Carriers not already involved in the marketplace will likely see that as a sign that legalization is on the horizon, and they'll be thinking about how they'll start writing cannabis coverage in the future.*
>
> **—Justin Sheerin, Jencap Associate Broker, Cannabis Practice**

In short, Sarah's cannabis operation in 2028 looks very similar to how it did just five years ago. Still, she is hopeful decriminalization is a sign that full federal legalization is on its way.

It's the year 2028. . .

CANNABIS IS A SCHEDULE II CONTROLLED SUBSTANCE

SCENARIO 2

Stephen opened Highlight Cannabis in 2018 and since then, the business has grown into a booming multistate operation (MSO). Highlight Cannabis first started as a medical cannabis business, focusing solely on medical-use-only states. As those states passed laws also allowing for recreational use, Highlight Cannabis expanded to also offer recreational options. Highlight Cannabis currently has 23 medical and recreational cannabis dispensaries and over 350,000 square feet of cultivation space across four states.

As a large cannabis business that works all along the value chain and across multiple states, Highlight Cannabis has navigated a vast range of operational complexities and risks through the years. But now, Stephen and his company are facing another looming business hurdle: responding and adapting to the federal government's recent decision to move cannabis to a Schedule II substance.

RESCHEDULING CANNABIS TO A SCHEDULE II SUBSTANCE

On the surface, moving cannabis to a Schedule II classification seems like a step forward for the industry—and in some ways, it is. While under the designation of a Schedule I controlled substance, cannabis sat alongside substances like heroin—all considered by the federal government to have a high potential for abuse and no acknowledged medical use. As a Schedule II substance, cannabis is still considered a controlled substance, but it has greater opportunities for research and study. It also will be much easier for the medical community to offer and prescribe it to patients.

However, this will all be done under the umbrella of federal regulation.

Now the federal government wants all products to undergo rigorous testing and FDA approvals. Cannabis businesses across the nation, including Highlight, are wondering what to do next since the products currently on their shelves don't meet these newly announced standards and requirements. This puts existing cannabis businesses—from the small mom-and-pop farms or shops to the labs, growers, manufacturers, and large multistate operators like Highlight Cannabis—in a precarious position that threatens their business.

IS THIS DOOMSDAY FOR THE EXISTING CANNABIS MARKET?

In the Attorney General and Secretary of Health of Human Services' joint announcement about the decision, existing cannabis businesses will be given several years of runway for this new change to go into effect—and it appears the government is attempting to handle the medical and recreational markets differently. Though their intention is to ultimately regulate the entire cannabis industry, they're choosing to turn their attention to the medical market first and allow states to continue to manage the recreational side, as they have in the past.

For businesses that operate exclusively in the medical market—growers, manufacturers, dispensaries, and labs—this feels like a death sentence. Some may try to pivot to the recreational side, hoping the government will allow states to continue regulating that market themselves. Others wonder if it's better to seek acquisition by one of the large, national pharmaceutical companies that have been waiting for the opportunity to operate in a government-sanctioned framework.

An even bigger fear for many medical businesses is whether there's a chance they'll be forced to pull products off their shelves and out of inventory or risk a federal raid that forcibly seizes inventory. Government action is excluded from most insurance policies, meaning in a situation like this, business will have little to no recourse for financial recovery.

> *If cannabis gets rescheduled to Schedule II, and the government strongly enforces that all cannabis to go through FDA approval, then yes, it could be the worst case scenario, where literally they're going to send federal officials in to raid and pull product off of shelves, whether it's medical or recreational.*
>
> **—Jodi Green, Counsel, Feldman Legal Advisors**

Although medical cannabis businesses are feeling the changes of the recent federal legislation most acutely, the recreational market isn't immune. Many on the recreational side worry that it's only a matter of time before the federal government steps in to impose regulation on them as well.

THE FUTURE IS HAZY

Highlight Cannabis, like all other cannabis operations, are left reeling as they work to figure out their next move. What will happen to all the existing products on their shelves? Is there a chance they'll get raided by federal law enforcement if they remain open? How will they be able to compete with the large pharmaceutical companies entering their space? Should they try to pivot out of the medical market and into recreational only to give themselves more runway?

SERVING AN INDUSTRY PLAGUED WITH UNCERTAINTY

In response to cannabis rescheduling, the cannabis insurance space is seeing major shake-ups as well.

> *Rescheduling could be a negative, for cannabis insurance as a whole, if it creates more uncertainty. Insurance companies do not like uncertainty. They make money by knowing what is going to happen and pricing things accordingly.*
>
> **—Jodi Green, Counsel, Feldman Legal Advisors**

For some businesses, securing insurance may become even more challenging than it has been in years past. If concern over government retribution continues to mount, carriers that were once willing to offer insurance to cannabis companies may no longer consider it worth the risk and pull back capacity.

That said, there will also be carriers and companies that view rescheduling as an opportunity to enter the market.

INFLUX OF NEW INSURANCE COMPANIES TO THE REGULATED MARKET

Now that the federal government has sanctioned cannabis for approved medical use, the admitted markets will likely respond by offering products for medical operations. Large insurance companies that already serve big pharma companies have been silently preparing in the background, positioning themselves to step into the cannabis market when the time is right. Now that there is a legal avenue for cannabis, the big hurdle that's kept many large insurance players out of the game is eliminated.

> *There's going to be a steep learning curve in the insurance marketplace if cannabis gets rescheduled. The policy forms are not going to be favorable to the risks they're insuring against. Businesses are going to need agents and brokers of a sophisticated level, who can walk them through the policy.*
>
> **—TJ Frost, Symphony Risk**

Despite their reach and scale, however, these larger insurance companies will have a steep learning curve as they learn to navigate the cannabis space. Legacy insurance companies will, to some extent, have an advantage over these new market entrants due to years of cannabis-related experience. However, they'll be forced to relearn and adapt to this shift in legislation. Those who do that well will rise to the top as insurers of choice.

CHANGES IN WHAT'S OFFERED AND AVAILABLE

With any market change, insurance adapts to offer products that meet current demand and need. For example, with the medical community able to more freely recommend and prescribe cannabis to patients, there's an increase in demand for professional lines and medical-related insurance for medical professionals.

Property insurance will also see some unique situations and circumstances from their insureds. Cannabis facilities are designed and built with a very specific, narrow purpose that doesn't apply broadly outside the cannabis industry. If rescheduling forces existing cannabis operations to close, they may not be particularly attractive real estate investments to anyone outside of the cannabis industry. This could mean a lot of buildings and properties being left vacant and moving from operating policies to vacant insurance policies.

INSURING MERGERS AND ACQUISITIONS ACTIVITY

Large pharmaceutical and medical companies wishing to quickly gain market share are seeing the opportunity to make good use of the smaller, existing medical cannabis businesses that have been in operation for years. Now that there are plans for a federally legalized framework for medical use (even though it's limited and tightly controlled), banks and financial institutions are more willing to engage in business. This gives large, capital-heavy pharmaceutical companies access to additional funding options and paves the way for mergers, acquisitions, and industry consolidation.

> *In this scenario, if cannabis becomes a Schedule II substance, there will be more consolidation because the bigger operations—particularly big pharma—are going to have access to banking and cheaper money.*
>
> **—Erich Schutz, Jencap Vice President, Cannabis Practice**

This increase in consolidation prompts demand for insurance products commonly used and expected as a part of merger or acquisition deals, including D&O, representation and warranty insurance, litigation buyout, contingent liability insurance, and a variety of tail coverages.

INSURING A RISKY BUSINESS

A world where cannabis is rescheduled to a Schedule II substance provides some federal legitimacy to the market, yet the tight restrictions it imposes severely limit the industry as a whole. More than ever, cannabis operators will need the support and guidance of their longstanding insurance partners to help create proper risk management plans and navigate the shifting landscape.

> *Even with a flood of admitted markets, I still think the legacy players exist in a Schedule II world because of longevity, experience, and support for the cannabis operators that we've had since day one.*
>
> **—Charles Pyfrom, CannGen Insurance**

It's the year 2028. . .

CANNABIS IS FEDERALLY LEGAL

SCENARIO 3

Master Green Garden is iconic in its home state of California. Founded in 2019, Master Green Garden is one of the largest cannabis growers in the state, with just shy of a million square feet of cultivation space. The majority of Master Green Garden's product grows in energy-efficient greenhouses, where they're able to continuously plant and harvest cannabis year-round.

In addition to selling a carefully curated line of products directly to consumers under the Master Green Garden brand, the company has a booming business-to-business operation. They sell their well-known brand wholesale to California cannabis retailers and offer a variety of white-labeled cannabis products that businesses can sell under their own packaging and name.

After almost a decade in business, Master Green Garden is moving into unchartered territory: Just a few months ago, the federal government officially ruled cannabis as fully legal in the United States.

AN INDUSTRY RIPE FOR CHANGE

Now that cannabis is no longer on the government's list of banned and controlled substances, the industry will be able to enjoy the benefits that other mainstream businesses take for granted, like access to banking, traditional tax advantages, interstate commerce, and more easily accessed insurance.

This newfound freedom, however, isn't without its challenges.

With legalization, a lot of traditional business opportunities would open up to cannabis operations. They could apply for trademarks, file for bankruptcy, access more banking options, and write off expense deductions. Legalization, in theory, should makes business more efficient and able to run more like mainstream industries.

—Lee Woodruff, Jencap Vice President, Cannabis Practice

THE STRUGGLE FOR STANDARDIZATION

Up until recently, Master Green Gardens, like all other cannabis businesses across the country, operated in a legal gray area. Although these businesses had state-issued licenses to operate within the borders of their respective states, cannabis was still regarded by the federal government as illegal. This created a patchwork of legislation from state to state, with little consistency and no opportunity for business between states.

With federal legalization comes the long-term goal of consistent industry practices and guidelines. Similar to alcohol and tobacco, the federal government has set parameters that all states must adhere to—such as who can buy and sell cannabis and in what amounts. But beyond that, there's still a lot of work to be done to establish a standardized framework for the cannabis industry across all states.

> *Let's say there is a law that gets passed that says we're [legalizing cannabis]. It could take years for the government to issue regulations and decide how to implement requirements for testing, labeling, and licensing. It could take years.*
>
> **—Jodi Green, Counsel, Feldman Legal Advisors**

At some point, there will be a system where every cannabis company knows exactly what they're supposed to put on their label, what they're supposed to test, and where and how they can sell their products. But that will take many years to sort out.

EVEN POSITIVE CHANGE CAN BE OVERWHELMING

Although long-term standardization will take time, cannabis businesses will still have to grapple with how they'll adjust their business operations to comply. For some businesses, that lift will be too great—especially if their states weren't appropriately prepared to handle the new federal legislation as it rolls out.

> *We need to start educating the states now on what happens [if cannabis is fully legalized]. When it goes federally legal, they're really going to be drinking out of Niagara Falls. [If they aren't prepared,] they're going to be working to keep up versus working to stay ahead.*
>
> **—TJ Frost, Symphony Risk**

Even states that legalized cannabis early on have struggled to keep up with the demands of managing and regulating cannabis operations. Many states tucked cannabis regulation under the purview of their existing liquor boards. However, the knowledge and experience needed to inspect restaurants and bars doesn't necessarily translate to inspecting dispensaries or cultivation and processing facilities.

In the wake of federal cannabis legalization, the already over-burdened state boards are now drowning, making it difficult for cannabis businesses (and business hopefuls) to fully understand what they need to stay compliant.

THE MEDICAL AND RECREATIONAL DIVIDE

The government has announced they have long-term plans to bring the medical cannabis market under stricter regulations and approval guidelines, similar to other pharmaceutical-grade products. But no one knows exactly how this will look, which has cannabis businesses that operate in the medical market understandably concerned.

Will they be able to transition their businesses to comply with whatever changes the government makes? Or will medical products only be available for purchase at pharmacies? Is it better to abandon the medical market entirely and attempt to transition their business to recreational? What does this mean for businesses in states that have historically been medical-only?

DON'T BET THE (CANNABIS) FARM

Master Green Garden has been itching to expand their market reach outside California. Up until now, they've throttled their possible production capacity, to avoid outpacing demand and winding up with more than they can sell. When cannabis was federally illegal, they were constrained to selling their product within the state of California. But now that cannabis is fully legal within the United States, they've set their sights on how they might expand into other states and sell their product across borders.

> *The minute interstate commerce opens up, I think the small-time operator states who can't produce volume and quality at scale will quickly dissipate, because the consumers' buying preferences will be toward those that are best in class for quality, potency, and consistency. If they live in Massachusetts and they can buy Great California Humboldt Cannabis, they're going to do that.*
>
> **—Charles Pyfrom, CannGen Insurance**

States like Wisconsin, for instance, entered the cannabis market much later than California and lack natural growing environments for high-yield cannabis production. While a business could choose to build a completely indoor grow facility in a cold climate, operations like Master Green Garden in sunny California can

produce more at cheaper costs, allowing them to offer lower prices. Indoor grow facilities can be expensive to heat and light, and businesses have to mark up their products accordingly.

Master Green Garden, and large growers like them, see a great opportunity to corner the market in states just building up their cannabis infrastructure by ramping up their own production and shipping across the country.

MORE STATES, MORE OPTIONS—AND MORE LIABILITY

What Master Green Garden may not initially realize, though, is the complexity of shipping across states. Although federal legalization makes interstate commerce possible, it's not as simple as throwing boxes of product in a truck and driving off.

Even within the federal regulations of free trade, the government could require special licensing to ship between states. When it comes to transporting products from state to state, legal compliance and insurance coverage go hand in hand. Businesses will need to comply with licensing requirements—as well as any other state and federal shipping or motor carrier regulations—before insurance companies will provide coverage.

In addition, shipping product from California to Wisconsin, for example, introduces a lot more liability and risk than shipping from So. Cal to San Francisco. Insurers will want to know how companies will track and trace products from one state to another and how Master Green Garden plans to mitigate risk across a dozen different states. This will be particularly challenging during the time when the nation is trying to establish some sort of standardized set of practices and each state is still managing things somewhat differently.

NOT ALL INSURANCE IS CREATED EQUAL

When Master Green Garden first began its operations almost a decade ago, they struggled to find sufficient insurance. Over time, more specialty and boutique carriers entered the cannabis market, willing to take on the risk of a profitable business in an evolving new industry. This gave Master Green Garden more options, but premiums remained high and policy terms weren't as favorable as those offered to more traditional, mainstream businesses.

Now that cannabis is federally legal, Master Green Garden will be able to shop around a bit more. Large commercial insurance companies in the admitted markets will step in with their own cannabis insurance offerings, ready to write new business. The increase in overall market capacity is good news for cannabis businesses. More competition in the insurance space means more coverage options, more favorable terms, higher limits, and better prices.

However, the savvy cannabis owner knows that in an industry as complex, dynamic, and nuanced as cannabis, it pays to seek out expertise. While the larger commercial insurance companies may have strong, nationwide brand recognition, they aren't necessarily experts in cannabis—especially compared to the smaller, legacy carriers who have been working within the cannabis industry for many years.

> *In a scenario where cannabis is descheduled, the surplus lines, markets, and carriers will continue to dominate the space. The industry will be slow to trust admitted carriers until they can demonstrate a robust understanding of the market.*
>
> **—Justin Sheerin, Jencap Associate Broker, Cannabis Practice**

CONCLUSION

JENCAP, YOUR GO-TO CANNABIS INSURANCE PARTNER

Whatever the future looks like for cannabis, the insurance industry will need to adapt and evolve alongside it. Partnering with a longstanding, specialized wholesaler like Jencap keeps you one step ahead and able to proactively meet your cannabis clients' needs, even in a complex and ever-changing environment.

Jencap's cannabis experts have devoted their careers to difficult-to-place risks. We have boots on the ground in every major cannabis market, fully understand the unique challenges of cannabis businesses, and stay on top of current state and federal legislation. Our fully customized, home-grown insurance solutions span every class of cannabis business and ancillary services—from the farm to the shelf.

Managing a cannabis business is complex enough, but finding adequate insurance coverage shouldn't be. With Jencap's unmatched reputation and market clout, you'll have access to a national network of non-admitted and A-rated cannabis carriers. You can rest easy knowing you're working alongside experts who adeptly cut through the messy tangle of regulations and policy forms to find the coverage your clients need. Contact Jencap today to learn more.

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