



# Banking Cannabis Customers

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# Agenda

- Current Legal Framework
  - Federal Law
  - Virginia Developments
- Potential Federal Legislative Developments
- Compliance Best Practices for Banking Cannabis

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# Legal Framework

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# U.S. Law

- Controlled Substance—illegal to manufacture, distribute, or dispense (21 U.S.C. §§ 812; 841)
  - Marijuana is Schedule I (no currently accepted medical use in treatment and lack of accepted safety for use under medical supervision)
- Criminal penalties: 18 U.S.C. §§ 1956-57, 1960; 31 U.S.C. § 5322.

# Federal Guidance

- DOJ (subsequently rescinded)
  - Memo—August 29, 2013 (announced 8 enforcement priorities)
  - Memo—February 14, 2014 (“[I]f a financial institution . . . offers services to a marijuana-related-business whose activities do not implicate any of the eight priority factors, prosecution for these offenses may not be appropriate.”)
- FinCEN
  - February 14, 2014 (“This FinCEN guidance clarifies how financial institutions can provide services to marijuana-related businesses consistent with their BSA obligations . . . .”)
- Other agencies (including NCUA and state banking regulators) have issued relevant guidance.

# Virginia Developments

- On April 7, 2021, Virginia became the first state in the South to begin the process of legalizing adult-use cannabis.
- What has been legalized so far (as of July 1, 2021)?
  - Adults 21 years and older may possess not more than one ounce of cannabis for personal use.
  - Adults 21 years and older may use marijuana in private residences.
  - Adults 21 and over may grow up to four plants per household (not per person), according to specified requirements.
  - “Adult sharing” or transferring one ounce or less of marijuana between persons who are 21 years or older without remuneration is legal. "Adult sharing" does not include instances in which (i) marijuana is given away contemporaneously with another reciprocal transaction between the same parties; (ii) a gift of marijuana is offered or advertised in conjunction with an offer for the sale of goods or services; or (iii) a gift of marijuana is contingent upon a separate reciprocal transaction for goods or services.

# Virginia Developments

- What remains illegal in Virginia (as of July 1, 2021)?
  - Possession of more than one ounce of marijuana.
  - It remains illegal for anyone under the age of 21 to consume, purchase, or possess marijuana, or to attempt to consume, purchase or possess any amount of marijuana.
  - It remains illegal to distribute or sell marijuana, and/or to possess any amount of marijuana with the intent to distribute or sell it. This prohibition applies equally to businesses, which will not be permitted to sell, “gift,” or in any other way distribute marijuana.
  - Existing safety measures remain in place, including prohibiting use of marijuana while driving a motor vehicle or while being a passenger in a motor vehicle being driven; possessing marijuana on school grounds, while operating a school bus, in a motor vehicle transporting passengers for hire, or in a commercial vehicle.
  - It remains illegal to consume marijuana or offer marijuana to another person in any public place.

# Virginia Developments

- On July 1, 2021, the law authorized the creation of the Cannabis Control Authority (CCA), a new, independent political subdivision (“an authority”) to regulate the marijuana industry, including issuing licenses for business
- Sales of marijuana will not be legal before January 1, 2024.
  - The law will create a new, independent political subdivision (“an authority”) to regulate the marijuana industry. While the Cannabis Control Authority can begin its work on July 1, 2021, it will take time for the authority to hire staff, write regulations, and implement equity and safety initiatives.
  - Many of the regulatory sections of the bill must be reenacted (approved again) by the 2022 General Assembly before becoming law.
  - Examples of types of licensed entities may include Marijuana cultivation facility; Marijuana manufacturing facility; Marijuana testing facility; Marijuana wholesaler; Retail marijuana store
- (Note that there are certain medical dispensaries that are authorized to dispense marijuana to registered patients)

# Hemp and CBD

- Cannabis sativa L.=either marijuana or hemp (0.3% or less THC)
- 2018 Farm Bill
  - Amended CSA to exclude hemp and hemp-derived products (as long as hemp-derived product has 0.3% or less THC) from definition of marijuana
  - Prohibits hemp production unless done in compliance with USDA-approved state plan, or unless done with a federal hemp license issued by USDA
  - On Oct. 31, USDA published interim final rule establishing the process that USDA will follow in reviewing state plans, and sets forth the USDA requirements that will apply to hemp producers in states where no USDA-approved plan exists
- CBD can be derived from both marijuana and hemp, and even after Farm Bill, CBD derived from marijuana is still a controlled substance under CSA, although CBD derived from hemp and with 0.3% or less THC is not
- FinCEN has issued guidance on how financial institutions should address hemp/CBD consistent with AML obligations



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# Legislative Developments

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# Activity On The Hill

- SAFE Banking Act
  - Intended to provide a safe harbor for financial institutions that provide financial services to MRBs. Note: The protections do not cover all potential liabilities, and there remains the possibility of enforcement actions for AML failures and other activities notwithstanding the intended safe harbor.
  - Safe Banking Act has passed the house, but future in the Senate remains uncertain.
- Marijuana Opportunity Reinvestment and Expungement Act (MORE Act)
  - Proposes to deschedule cannabis from the Controlled Substances Act and enact various criminal and social justice reforms.
  - House has previously passed the MORE Act.
- Other Developments
  - Senators Schumer, Booker, and Wyden have been working to develop the Cannabis Administration and Opportunity Act. The bill would decriminalize cannabis federally but would allow states to prohibit its possession, production, and distribution.

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# Regulatory Environment

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# Enforcement

- In February 2021, NCUA imposed a cease-and-desist order against Live Life Federal Credit Union in Michigan.
- Requires the credit union to stop opening new accounts for MRBs, immediately file missing suspicious activity reports (SARs) for customers (including, presumably, MRBs), and develop and implement an automated system to monitor for suspicious transactions.
- Agreed to “[i]mmediately develop and implement a system to ensure all Currency Transaction Reports are filed accurately...”
- Live Life also agreed to stop providing services to MSBs.

# Enforcement

- Previously, we are aware of only one enforcement action by federal and state authorities against financial institutions providing services to MRBs.
  - In July 2016, Millennium Bank, a \$75 million-asset financial institution with a single branch based in Illinois entered into a consent order with the FDIC and the Illinois Division of Bank.
  - The media reported that the matter was focused on alleged BSA/AML compliance deficiencies related to the bank's provision of services to MRBs.
- We are aware, anecdotally, of other non-enforcement matters where regulators have required banks to shut down MRB programs where the banks did not have adequate policies and procedures in place.

## At the end of the day . . .

- Given the position taken by the federal government to date, it appears unlikely that a law enforcement action would be brought against an FI or one of its compliance officers based on the *mere fact* the FI is providing banking services to the cannabis industry.
  - The prudential banking regulators have issued guidance and made public statements on how FIs can provide services to MRBs consistent with their legal and regulatory compliance obligations.
  - These enforcement agencies are well aware that banks and credit unions in numerous states are providing services to MRBs.

## At the end of the day . . .

- Instead, the risk of an enforcement action is likely to be in
  - failing to implement and manage an appropriate MRB compliance program,
  - ignoring compliance deficiencies in the AML program, or red flags with respect to specific MRBs,
  - engaging in additional, unlawful conduct involving the MRB Program (e.g., assisting a MRB in engaging in activity that violates state laws), or
  - disregarding any directions or orders issued by a regulator with respect to the MRB Program.
- In other words, while there will always be a degree of risk given the federal illegality of cannabis, the more practical risk for a compliance officer is failing to implement and manage an appropriate risk management program.

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# Compliance Programs for Banking Marijuana

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# AML Program Focused on MRBs

- In the marijuana context, financial institutions should establish dedicated MRB-specific components within their AML programs in connection with a comprehensive product offering tailored to the industry (rather than accepting MRB customers on an *ad hoc* basis).
- Transparency with regulators is key – reach out in advance and provide overview of scope of program, compliance, etc.

# Start with the Basics

- Leadership and culture starts at the top, and a program requires clear lines of communication and the dedication of resources.
- Leverage and build upon existing AML infrastructure, but with a focus on marijuana-specific policies and procedures
  - Board reporting
  - Adequate resources and staffing
  - Quality assurance reviews
  - Audits
  - Training
- Understand state laws and regulations for licensed entities, so that the AML program can be tailored for state-specific requirements.

# Key Areas of Focus

- Due diligence and reviews of MRB lines of business, corporate structure, operations, and licensing;
- Evaluation of the advertising, marketing, sales practices, and business relationships;
- Understanding any prior banking relationships, and other current banking relationships;
- Monitoring transactions for suspicious activity, including transactions between corporate and personal accounts;
- Currency transaction reporting (which will increase significantly with MRBs);
- Suspicious activity reporting, including limited, priority, and termination suspicious activity reports (“SARs”), some of which are MRB-specific; and
- Site visits and confirmation of information provided by MRBs in response to periodic reviews.

# CIP/CDD/EDD

- The FinCEN Guidelines clarify that the decision to open, close, or refuse any particular account should be made by each financial institution based on its business objectives and an evaluation of the risks associated with offering a particular product or service.
- A financial institution can only assess these risks through a combination of rigorous due diligence on applicants and comprehensive, ongoing monitoring throughout the life of the account.

# FinCEN Guidance

- Red Flags include:
  - Business receives substantially more revenue than local competitors or than might be expected given the population demographics
  - Rapid movement of funds
  - Deposits by third parties with no apparent connection to account holder
  - Financial statements provided are inconsistent with actual account activity

# CIP/CDD/EDD

- Classification of MRB customers is important for allocating resources and managing risk. There are various ways that banks have classified customers, but almost all group customers into “licensed entities” or “entities that touch the plant”(often called Tier I MRBs) and other businesses that receive revenue from providing services to Tier I MRBs.
- Example of possible classification structure:
  - **Tier I**--Directly manufacture, dispense, or distribute cannabis, or otherwise required by state law to obtain a license.
  - **Tier II**--Focus a substantial portion of its business on the cannabis industry? Derive significant revenue from cannabis, or advertise/market itself as serving the industry.
  - **Tier III**--Serve the industry but derive a lesser portion of revenue from cannabis.
  - **Other**—Derive small portion, not subject to MRB program but should monitor annually.

# Information Collection

- Depending on Tier:
  - Address of all licensed locations
  - Nature of business
  - Entity structure
  - Disclosure of prior banking relationships
  - Copies of all licenses
  - Financial statements and tax returns
  - Expected activity (cash, ACH, wire, check)
  - List of all vendors or other payees
  - Policies and procedures of business
  - Copies of contracts with Tier I entities
  - Onsite visit

# Risk Rating

- In addition to classifying customers into Tiers, it is helpful to further risk rate customers (Low, moderate, or high) based on individual characteristics
  - Single or multiple locations
  - Revenue
  - Account balance
  - New or existing customer

# Ongoing Monitoring

- Depends on tier level and risk rating
  - Marijuana SAR or regular SAR
  - Periodic review (monthly, quarterly, semi-annually, annually)
    - Licensing
    - Transaction data
    - Compare activity to estimates of cash, wires, ACH, checks
    - Permitted variance
    - Review comparables
  - Onsite audits

# SARs

- The FinCEN guidance establishes unique suspicious activity reporting (SAR) procedures for MRB-related accounts.
  - “Marijuana Limited” SAR: Filed when FI provides financial services to a marijuana-related business that it reasonably believes, based on its customer due diligence, does not implicate one the of the Cole Memo priorities or violate state law.
  - “Marijuana Priority” SAR: Filed when FI reasonably believes, based on its customer due diligence, that an MRB implicates one of the Cole Memo priorities or violates state law.
  - “Marijuana Termination” SAR: Filed when FI deems it necessary to terminate a relationship with an MRB in order to maintain an effective anti-money laundering compliance program, it should file a SAR and note in the narrative the basis for the termination.

## Other Questions that May Arise

- Will the FI provide ACH/Wire services? In-state or out-of state? What about to states where marijuana remains illegal?
- Will the FI allow deposits in branches? Or will it require an armored card services?
- Will the FI provide services to the owners and employees of an MRB? What type of diligence will be conducted?
- Will the FI provide commercial loans to MRBs?
- Will the FI provide services only in states in which it has a branch? Or will it provide services nationwide?



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