

## **Banking Marijuana Related Businesses**

Nationwide, marijuana is now legal for medical purposes in 33 states and the District of Columbia, while recreational marijuana has been legalized in 10 of those states and the District of Columbia. This has far reaching implications for financial institutions in the states where marijuana has been legalized in some capacity. Financial institutions are encouraged to define their risk tolerance for banking Marijuana Related Businesses (MRBs) and develop a risk-based policy addressing MRBs.

At this time, there is no clear definition on what constitutes an MRB however, the Small Business Administration provides some useful guidance that may inform your institution's policy and help to define the level of risk, if any, that your institutions is willing to take. In 13 CFR 120.110 (h) the SBA states businesses engaged in any activity that is illegal under federal, state, or local law are ineligible for SBA business loans. Additional guidance to address businesses that derive revenue from marijuana related activities or that support end-use of marijuana is provided SBA Policy Notice 5000-17057, effective April 3, 2018.

The policy notice states that because federal law prohibits the distribution and sale of marijuana, financial transactions involving MRBs would generally involve funds derived from illegal activity therefore, businesses that derive revenue from MRB activities or that support end-use of marijuana may be ineligible for SBA Financial Assistance. Eligibility is determined by a business's operations.

- A "direct marijuana business" is one that grows, produces, processes, distributes, or sells marijuana or marijuana products, edibles, or derivatives, regardless of the amount of the activity. This applies to personal and medical use even if the business is legal under local or state law where the business is located.
- An "indirect marijuana business" is one that derives any of its gross revenue from sales to Direct Marijuana Businesses of products or services that could reasonably be determined to support the use, growth, enhancement, or other development of marijuana. Examples are those that sell grow lights or hydroponic equipment to a direct marijuana business or those that sell smoking devices such as pipes, bongs, inhalants or other products that may be used in connection with marijuana if the products are primarily intended or designed for such use or if the business markets the products for such use.
- A "hemp-related business" is one that grows, produces, processes, distributes or sells products purportedly made from hemp.

A financial institution may also consider different levels of association when formulating their MRB policy. The first level would include those entities that are generally referred to as MRBs - those that grow, process, transport, or dispense marijuana, for example. A second level customer would include those that provide goods or services to the MRBs such as equipment vendors, suppliers, those providing security, and employees of the primary MRB. Third level customers could include property managers or landlords/property owners and professional service providers. A footnote in the FinCEN guidance distinguishes between an MRB and a non-financial customer that provides goods or services to an MRB such as a landlord. This implies that a non-financial customer that provides goods or services to an MRB is not itself an MRB and although a SAR would have to be filed, it would not be a marijuana SAR as defined in the Cole Memo.

A financial institution that is considering banking marijuana related businesses should first determine what the Bank's risk tolerance is and how the activity will fit within the Bank's strategic policy. As in other areas of AML/BSA, the Bank should take a risk-based approach to making their decision about providing services to MRBs or not. One should consider not just the risks of banking MRBs (including prosecution, onerous due diligence, monitoring, and reporting requirements, risks to employees and customers resulting from large amounts of cash being deposited, and reputational risk), but the possible benefits as well. Banking MRBs may provide a steady source of deposits, alleviate public safety concerns by helping to bring this activity out into the open instead of driving it underground, assist with tax collection, and enhance the Bank's earnings performance. While the official position of regulators is to remain neutral and neither encourage nor discourage this activity, you should be prepared to share your strategy with your regulator and be open to suggestions from the regulator.

Your decision to provide or not provide services should be addressed in a Board approved MRB Policy that addresses BSA requirements and FinCEN guidance. In addition, if your institution decides to provide services, the policy should address the resources (number of people, experience of people, any outsourcing that will be done, transaction monitoring systems, etc.) that will be devoted to managing these services. There should be a profitability analysis to document the overall financial impact taking into account resources and revenues. The Board of Directors should define and approve risk limits including the risk appetite of the Bank, the percent of capital that can be derived from these businesses, the number of clients the Bank is willing and able to take on, and what percentage of total deposits will be made up of MRB deposits. The Bank will need a well-defined exit strategy that will define how the institution will/can exit a particular relationship or how the Bank will/can exit the entire program quickly, if necessary.

Those institutions that decide to provide services to MRBs, should look to FinCEN for guidance on doing so. The guidance clarifies how financial institutions can provide services to MRBs consistent with their BSA obligations and align the information provided by financial institutions in BSA reports such as CTRs and SARs with federal and state law enforcement priorities. The guidance also states that a decision to open, close, or refuse a relationship requires an evaluation of the risks and the Bank's ability to manage those risks effectively. The guidance addresses due diligence a bank must undertake if banking MRBs and requires that banks consider whether a MRB violates state law or implicates one or more of the following Cole Memo priorities:

- prevent the distribution of marijuana to minors;
- prevent revenue from sales from going to criminal enterprises, gangs, and cartels;
- preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- preventing violence and use of firearms in the cultivation and distribution of marijuana;
- preventing drugged driving and exacerbation of other adverse public health consequences associated with marijuana use;
- preventing the growing of marijuana on public lands and the attendant public safety and environmental danger posed by marijuana production on public lands; and
- preventing marijuana possession or use on federal property.

The FinCEN memo also provides guidance on the types of SARs that will be required when a Bank chooses to provide services to a MRB.

- Marijuana limited SARs are to be filed when a bank reasonably believes the MRB does not implicate one of the Cole Memo priorities or violates state law
- Marijuana priority SARs are to be filed when a bank reasonably believes the MRB implicates one of the Cole Memo priorities or violates state law
- Marijuana termination SARs are to be filed when the bank deems it is necessary to terminate a relationship with a MRB in order to maintain an effective AML program.

Banks must conduct ongoing due diligence of MRBs with special attention paid to red flags that an MRB may be engaged in activity that implicates one of the Cole Memo priorities or violates state law. Red flags may include the following:

- A customer appears to be using a state-licensed marijuana-related business as a front or pretext to launder money derived from other criminal activity (i.e., not related to marijuana) or derived from marijuana-related activity not permitted under state law. Relevant indicia could include:
  - The business receives substantially more revenue than may reasonably be expected given the relevant limitations imposed by the state in which it operates.
  - The business receives substantially more revenue than its local competitors or than might be expected given the population demographics.
  - The business is depositing more cash than is commensurate with the amount of marijuana-related revenue it is reporting for federal and state tax purposes.
  - The business is unable to demonstrate that its revenue is derived exclusively from the sale of marijuana in compliance with state law, as opposed to revenue derived from (i) the sale of other illicit drugs, (ii) the sale of marijuana not in compliance with state law, or (iii) other illegal activity.
  - The business makes cash deposits or withdrawals over a short period of time that are excessive relative to local competitors or the expected activity of the business.
  - Deposits apparently structured to avoid Currency Transaction Report (“CTR”) requirements.
  - Rapid movement of funds, such as cash deposits followed by immediate cash withdrawals.
  - Deposits by third parties with no apparent connection to the account holder.
  - Excessive commingling of funds with the personal account of the business’s owner(s) or manager(s), or with accounts of seemingly unrelated businesses.
  - Individuals conducting transactions for the business appear to be acting on behalf of other, undisclosed parties of interest.
  - Financial statements provided by the business to the financial institution are inconsistent with actual account activity.
  - A surge in activity by third parties offering goods or services to marijuana-related businesses, such as equipment suppliers or shipping servicers.
- The business is unable to produce satisfactory documentation or evidence to demonstrate that it is duly licensed and operating consistently with state law.
- The business is unable to demonstrate the legitimate source of significant outside investments.
- A customer seeks to conceal or disguise involvement in marijuana-related business activity. For example, the customer may be using a business with a non-descript name (e.g., a “consulting,” “holding,” or “management” company) that purports to engage in commercial activity unrelated to marijuana, but is depositing cash that smells like marijuana.

- Review of publicly available sources and databases about the business, its owner(s), manager(s), or other related parties, reveal negative information, such as a criminal record, involvement in the illegal purchase or sale of drugs, violence, or other potential connections to illicit activity.
- The business, its owner(s), manager(s), or other related parties are, or have been, subject to an enforcement action by the state or local authorities responsible for administering or enforcing marijuana-related laws or regulations.
- A marijuana-related business engages in international or interstate activity, including by receiving cash deposits from locations outside the state in which the business operates, making or receiving frequent or large interstate transfers, or otherwise transacting with persons or entities located in different states or countries.
- The owner(s) or manager(s) of a marijuana-related business reside outside the state in which the business is located.
- A marijuana-related business is located on federal property or the marijuana sold by the business was grown on federal property.
- A marijuana-related business's proximity to a school is not compliant with state law.
- A marijuana-related business purporting to be a "non-profit" is engaged in commercial activity inconsistent with that classification, or is making excessive payments to its manager(s) or employee(s).

The decision to provide banking services to MRBs requires careful analysis, planning, and Board oversight. Any financial institution that decides to provide services should have a well-developed, risk-based MRB Policy that clearly defines the services that will be provided, the risks of providing the services, how risks will be mitigated including the allocation of resources and managerial and executive oversight. The policy and procedures should allow the Bank to offer these services without a significant change to the Bank's overall risk profile. The Bank should set a fee schedule that covers the costs associated with offering the services and allows for profitability. Strict adherence to any agreement the Bank and MRB engage in should be strictly enforced. There should be a zero-tolerance policy for activity engaged in by the MRB that contradicts the terms of the agreement to provide services and the Bank should have a well-developed exit strategy to allow for the Bank to exit individual relationships or the entire program quickly and without adverse effect. While many financial institutions are wary of providing these services, there are currently over 350 financial institutions in the United States doing so and for those who decide to offer the services, if done right, the benefits can outweigh the risks.