

Weeding Through

THE CHALLENGES OF BANKING THE MARIJUANA INDUSTRY

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Introduction

With 22 states and the District of Columbia allowing the use of marijuana for medicinal purposes and two of those states, Colorado and Washington, legalizing marijuana for recreation drug use, financial institutions (FIs) are faced with addressing the challenges of the legalization of marijuana at the state level while it remains illegal at the federal level. Outside of the more evident legal and political challenges that have been discussed in several recent articles published throughout the industry and which will not be the main focus of this paper, FIs must weed through those challenges to ultimately address what challenges impact their FI. Three noteworthy challenges faced by a FI regarding the marijuana industry are as follows:

- The FI's decision whether or not to offer services to a marijuana-related business. For this paper a marijuana-related business is defined as a business that grows, processes, transports and dispenses marijuana such as, but not limited to, marijuana dispensaries and/or medical marijuana farms.
- If a FI is going to offer services, implementing a monitoring program for marijuana-related businesses that aligns with best practices and industry standards.
- The FI's responsibilities to review existing anti-money laundering (AML) programs to ensure adequate monitoring and due diligence controls are in place to identify and report emerging trends and associated risks as a result of the industry not having access to FIs.

The heart of these challenges exist as a result of the lack of harmony between state and federal laws not acting with effective, direct guidelines for an industry in its infancy. Earlier in 2014, the Financial Crimes Enforcement Network (FinCEN) and the Justice Department provided guidance for FIs on servicing marijuana-related businesses; however, this guidance offered very little clarity on what specific compliance obligations and methods should be implemented to mitigate the risks.¹

The objectives of this white paper are to assist FIs by:

- Presenting current viewpoints of banking marijuana-related businesses
- Interpreting regulatory guidance issued by the Department of Justice (DOJ) and FinCEN
- Proposing guidance to enhance marijuana law to allow for transparency to FIs
- Formulating best practices and industry standards for FIs to effectively monitor marijuana-related business accounts
- Addressing risks involved with marijuana-related businesses
- Discussing alternative banking methods used by marijuana-related businesses

The purpose of this paper is to give industry professionals and financial institutions a better understanding of the potential ramifications of banking marijuana-related businesses. If a financial institution chooses to bank the marijuana industry, the paper will assist a FI in offering financial services to marijuana-related

¹ Kneiff, Ben. Legalized Marijuana – Stinking Challenge or Budding Opportunity? (February, 19, 2014). Financial Crime Partners. May 14, 2014 <http://www.fincrimetpartners.com/legalized-marijuana-stinky-challenge-budding-opportunity/>

businesses while implementing a compliance monitoring program that aligns with the issued guidance and existing regulations. While the proposed recommendations are not exhaustive, it will provide a foundation on which to begin setting industry standards for due diligence requirements.

Current Viewpoints

The federal government regulates marijuana as a scheduled 1 drug through the Controlled Substance Act (CSA) (21 U.S.C. § 811), which means the federal government views marijuana as highly addictive and having no medicinal value.² The cultivation, possession and distribution of marijuana are illegal under the Federal Controlled Substances Act, and any proceeds deriving from those transactions would be proceeds of an illegal transaction.

Individual state laws do not always conform to the federal standard. Acknowledging the use, sale and possession of marijuana in the U.S. is still illegal under federal law; several states have legalized marijuana in some form.

As a result of the differing viewpoints between state and federal law, the Treasury Department and Justice Department have issued separate advisories intended to give banks confidence that if they are compliant with the guidance, they will not be prosecuted for providing services to legitimate state-licensed marijuana businesses. The Treasury Department issued FIN-2014-G001– Bank Secrecy Act (BSA) Expectations Regarding Marijuana-Related Businesses on February 14, 2014, and the DOJ issued a memorandum entitled “Guidance Regarding Marijuana-Based Financial Crimes.” The memorandum issued by the DOJ is a follow-up to an August 29, 2013 memo also containing guidance to federal prosecutors concerning marijuana enforcement under the Controlled Substance Act. The memorandum issued by the DOJ does not grant a safe harbor from prosecution, but directs prosecutors and regulators to give priority to cases where FIs have failed to adhere to the memorandum. The guidance issued by the Treasury Department clarifies how FIs can provide services to marijuana businesses while maintaining their obligations to comply with the BSA. Additionally, the guidance allows access to financial services for marijuana-related businesses while ensuring their activity is transparent and there are appropriate AML safeguards implemented. Safeguards may include, but are not limited to, adequate customer due diligence (CDD), ongoing monitoring, enhanced due diligence (EDD), and proper suspicious activity report (SAR) reporting. SAR reporting has been enhanced to include a new classification of SARs related exclusively to the marijuana industry.

² United States Department of Justice. Office of Diversion Control. Title 21 United States Code (USC) Controlled Substance Act: Subchapter I – Control and Enforcement. August 13, 2013

Even so, FIs have been reluctant to offer financial services to marijuana-related businesses. "Banks are responsible to regulators, most of which are independent and uncontrolled by the president's executive branch. The idea of no prosecution is nice, but banks regulators have the real power," wrote Don Childears, president of the Colorado Bankers Association, in a statement.³ Until Congress passes legislation legalizing marijuana, ultimately FIs will remain concerned about violating federal law risking the potential of grave consequences from regulatory agencies imposing various civil monetary penalties, cease and desist orders, fines and banishment of bankers from their careers for life. Regardless of what the DOJ says, regulators can still bring down harsh penalties on FIs.

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Regulatory Guidance

Cole Memo

The DOJ released an update to the Marijuana Enforcement Policy on August 29, 2013, as a result of the state initiatives to legalize under state law the possession of small amounts of marijuana and provide for the regulation of marijuana production, processing and sale. The update makes clear that marijuana remains an illegal drug under the Controlled Substance Act and federal prosecutors will continue to enforce the statute. To this end, the DOJ reiterated the eight enforcement areas that federal prosecutors should prioritize. The areas address distribution of marijuana to minors, revenue from the sale of marijuana going to criminal enterprises, diversion to states where it remains illegal, trafficking, cultivation, distribution, drugged driving, and prevention of growing marijuana on public lands and possession of marijuana on federal property. Outside of these priorities, the federal government will continue with existing policies and rely on state and local authorities to address marijuana activity through enforcement of their own narcotics law. For states that have enacted laws to authorize the production, distribution and possession of marijuana, the DOJ expects these states to establish strict regulatory schemes that protect the eight federal interests identified in the DOJ's guidance. These schemes must be tough in practice, not just on paper, and include strong, state-based enforcement efforts backed by adequate state funding. But if any of the stated harms do materialize, either despite a strict regulatory scheme or because of the lack of one, federal prosecutors will act aggressively to bring individual prosecutions focused on federal enforcement priorities and the Department may challenge the regulatory scheme themselves in these states.⁴

³ Armbrister, Molly. Banking Marijuana will still take an act of Congress. (February 14, 2014) [Northern Colorado Business Report](http://www.ncbr.com/article/20140214/NEWS/140219943&source=RSS). May 17, 2014. <http://www.ncbr.com/article/20140214/NEWS/140219943&source=RSS>

⁴ Cole, James. United States Department of Justice. Office of the Deputy Attorney General. "[Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement](#)." Washington: August 29, 2013

FinCEN

In prepared remarks at the 19th Annual ACAMS International AML and Financial Crimes Conference held on March 18, 2014, Jennifer Shasky Calvery, director of FinCEN, addressed FinCEN's efforts to promote greater financial transparency in the marijuana industry and the ability to provide services to marijuana-related businesses consistent with their BSA obligations. According to Shasky Calvery, FIs should:

1. Perform EDD to ensure appropriate licensing and registration. This would include requesting and verifying with the appropriate state authorities whether the business is appropriately licensed and registered.
2. Develop an understanding of the normal and expected activity for the business. The key is whether the business is serving medicinal or recreational customers and taking into consideration the products sold.
3. Implement ongoing monitoring of publically available sources for adverse information about the businesses and related parties.
4. Monitor for suspicious activity including the red flags described in the guidance.
5. Maintain current due diligence on the customer by performing periodic reviews.
6. Assess whether the marijuana-related businesses violates one of the Cole Memo priorities or state law.
7. File SARs on marijuana-related businesses (including those licensed under state law) in accordance with suspicious activity reporting requirements and the provisions addressed in the FinCEN guidance.
8. Report currency transactions in connection with marijuana-related businesses consistent with existing regulations and thresholds. Marijuana-related activity may not be treated as non-listed businesses and therefore is not eligible for exemption with respect to the financial institution's currency transaction report (CTR) obligations.

FinCEN also imposed a new and unprecedented obligation on FIs. If a FI learns that after terminating its relationship as a result of filing a "Marijuana Termination" SAR, and subsequently the marijuana-related company seeks out a new financial institution, it is strongly urged to alert the second bank of the potential illegal activity.⁵ This should be executed through the 314(b) Voluntary Information Sharing. Despite the guidance, banks are aligning with federal laws and not offering financial services to these businesses. However, it has been suggested that small community banks may be the first to step up to the plate because the revenue from marijuana businesses would be more significant to them.⁶

FinCEN and the DOJ, individually or collectively, should define what constitutes a marijuana-related business and what business activities fall into that definition. For example, if a business grows, cultivates, manufactures, or sells marijuana, under the definition, the business is considered a marijuana-related business; however, the definition or subsequent guidance should be issued to also address entities that provide essential business services or support to marijuana-related businesses such as an accounting firm, electricians, lawyers, landlords, etc.

⁵ Shashky-Calvery, Jennifer. "Prepared Remarks of Jennifer Shashky Calvery: Association of Certified Anti-Money Laundering Specialist 19th Annual International AML Financial Crime Conference." March 18, 2014

⁶ Weisbaum, Herb. "CNBC: Banks balk on marijuana money despite US guidelines." (Feb. 21, 2014) CNBC. May 17, 2014 <http://www.cnbc.com/id/101433431#>

Marijuana State Laws

Shaping Marijuana Law

With 30 states including the District of Columbia considering marijuana law reform legislation this year including bills that cover legalization for adults, decriminalization, medicinal marijuana and hemp, FIs need to be proactive in providing guidance to legislators on the current challenges faced by institutions. State representatives are likely unaware or do not have a full understanding of the ramifications of legalizing marijuana without the ability for marijuana-related businesses to utilize the financial system.

On January 15, 2014, Senate Bill No. 1182, the Compassionate use of Medical Cannabis Act, was introduced by Senator Mike Folmer to provide the medicinal use of cannabis for the Commonwealth of Pennsylvania. This paper's author held a meeting with Senator Mike Folmer and his chief of staff, Fred Sembach, regarding the current issues associated with banking marijuana-related businesses. During the open discussion, it was revealed to this author, that state representatives were not aware of the current issues financial institutors face regarding banking marijuana-related businesses and the subsequent ramifications of related businesses not having access to the banking system.⁷

In states where marijuana laws are being introduced, bankers and banking organizations must be proactive in meeting with state representatives. Discussions need to address the current requirements set forth in the Cole Memo and FinCEN guidance on banking marijuana businesses to assist state representatives in their understanding of what FIs will need from the state in order to comply with the due diligence recommendations in the guidance.

In states where marijuana laws are being introduced, bankers and banking organizations must be proactive in meeting with state representatives.

When a representative of a financial institution or a proactive industry professional meets with a state representative who is introducing new law surrounding the legalization of marijuana, areas to be discussed with the state representatives for their consideration while drafting marijuana bills should include:

- Develop a clear and transparent avenue for banks to verify with state authorities that the business is duly licensed and/or registered appropriately as a marijuana-related business. This should

⁷ Folmer, Mike. Senator 48th District, Senate of Pennsylvania. Personal interview. May 27, 2014

included providing copies of documents or an attestation of compliance with license and registrations. FIs will need the ability to request the information on a periodic basis to ensure the FI maintains the most current information regarding state licenses in connection with the customer.

- Make available through an appropriate channel, the ability for FIs to review as requested the license application and other related documents used by the state in determining the appropriateness of granting licenses. Banks may compare these documents to those provided by the marijuana dispensaries during account opening.
- Provide the FIs with available information about the business and related parties such as results of inspections and monitoring compliance with provisions and regulations under state law.
- Provide financial intuitions within the state a listing of the number of licenses granted to businesses including owners and/or individuals and whether they are in good standing. The list should include name of business, address, tax ID number, key management/owners and their related identifying information. The bank should be able to use this listing to verify the accuracy of the information they have on file for the marijuana-related businesses as well as scrub their existing database to assist in identifying accounts that may not be identified as marijuana-related businesses.
- Make available to FIs annually the number of people within the state who are registered to legally purchase medicinal cannabis and the amount of cannabis cultivated, manufactured and sold within the state. This will assist FIs in addressing marijuana-related risks within the AML/BSA risk assessment
- Ability for FIs to be made aware, at their inquiry, if an investigation has been initiated on the marijuana-related business by state or federal authorities.
- Capability to verify the medicinal cannabis identification card both for individuals and businesses. FIs will need a channel to verify the authentication of the card if they choose to allow the card as an acceptable form of identification at account opening.
- Require marijuana-related businesses to have a written and effective AML/BSA program that contains at least the designation of a compliance officer, internal policies, procedures and controls, ongoing relevant training of employees, and independent testing and review.
- Subject marijuana-related businesses to an examination for AML compliance by the Internal Revenue Service (IRS).
- Understand how law enforcement and the state laws function to ensure the following:
 - Preventing the distribution of marijuana to minors;
 - Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
 - Preventing the cross border transfer of marijuana in some form from states where it is legal under state law 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 the use of firearms in the cultivation and distribution of marijuana;
 - Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
 - Preventing the growing of marijuana production on public lands; and,
 - Preventing marijuana possession or use on federal property.

Due to the privacy concerns requesting and obtaining the information addressed above, this process may be better facilitated through a confidential channel similar to 314(a) and (b) under the USA PATRIOT Act to assist in mitigating the privacy risk.

By FIs taking a proactive approach to assist state legislators in shaping marijuana laws, it will assist in allowing for transparency and direct lines of communication for the FI to comply with regulatory standards. Additionally, it will contribute to setting a standard for states considering legalizing marijuana and further facilitate a cohesive culture between state representatives and FIs to the federal government.

Understanding Marijuana Law

For states that have already legalized marijuana for medicinal or recreational purposes, it is apparent that marijuana laws are constantly changing and vary drastically in their scope and implementation, including the regulation of dispensaries across state lines. It is imperative for banks to understand the state laws and penalties governing medical marijuana dispensaries, including the process to register marijuana facilities and restrictions to individuals who can sell, purchase, and receive medicinal marijuana from a dispensary. FIs should be aware of restrictions to locations for dispensaries, security requirements and, more notably, the ongoing oversight and monitoring to ensure the dispensaries are acting in a manner consistently with laws and regulations. Awareness of the information made available by state licensing authorities will contribute to the bank's ability to comply with CDD requirements.

It is imperative for banks to understand the state laws and penalties governing medical marijuana dispensaries, including the process to register marijuana facilities and restrictions to individuals who can sell, purchase, and receive medicinal marijuana from a dispensary.

Evaluation of State Law(s) Governing Marijuana

To begin, FIs should perform an assessment of state's marijuana-related laws. The documented assessment will provide an understanding of the approval requirements to open or service a marijuana-related business and issue marijuana related identification cards. The items below address several key components of the marijuana-related laws that a FI should consider evaluating:

- The application and approval process and criteria to grant identification cards, business and transportation licenses
- Oversight, monitoring and enforcement of marijuana-related businesses
- Laws and regulations surrounding the cultivation, manufacturing, sale and distribution of cannabis
- Restrictions in which individuals or businesses will not be granted a license or identification card. For example: Does the state disqualify an individual(s) from obtaining or possessing a license because the individual has previously committed a felony and/or been sentenced for a violation of state or federal law related to controlled substances?

- Renewal process of identification cards and business licenses
- The due diligence and ongoing information marijuana-related businesses must provide to the state. Examples:
 - Does the state require a cannabis center to provide a report detailing the amount and what types of cannabis the center has distributed during the past month?
 - Does the state require a medical cannabis farmer to submit a report detailing how much and what type of cannabis the farmer has distributed during the past month?
- The ability to obtain documentation from the state

Based on the assessment, FIs should use the information to assist in developing a risk-based due diligence program commensurate with state and federal law and identify gaps and weaknesses in the scope of state law. FIs should develop policies, procedures and controls to assist in bridging the gap.

Direct and Indirect Risk Factors

In considering whether to provide financial services to businesses in states where it has been legalized, a financial institution must understand the overall risk profile of marijuana-related businesses factoring in the knowledge gained from a state law assessment. This will assist the bank in applying appropriate risk management processes throughout the enterprise-wide risk management program and more specifically, the BSA/AML compliance program. Whether or not the bank offers services to marijuana-related businesses, the bank should address its position and direct and indirect risks in the overall AML/BSA Risk Assessment and AML/BSA Policy. Furthermore, FIs should make enhancements in the SAR and CTR policies and procedures to reflect the new guidance.

In order for a financial institution to begin to address the direct and indirect risk exposure to the marijuana industry, the following questions should be considered:

- Does the institution operate in a state or states where cannabis is legal or pending legalization? If so, does it mostly operate in legalized or non-legalized states?
- Does the institution maintain customer relationships with:
 - Real estate leasing companies whose tenets may include cannabis-associated businesses?
 - Companies that sell or lease equipment that may be used in the production or sale of cannabis?
 - Third-party payment processing (TPPP) customers that facilitate cannabis-related transactions?
 - Payroll service providers organized in states that have legalized marijuana?
 - Money services businesses (MSB) organized in or operating in authorized states?
 - High net-worth or private clients with entrepreneurial investment histories or located in legalized jurisdictions?
 - ATM manufactures or providers with operations in these jurisdictions?
- Does the institution maintain relationships with private security firms and/or armored car services located in legalized jurisdictions? Note that these may also be potential customer relationships.)
- Does the FI invest in start-up businesses or provide services to private equity firms, venture funds or other customers that may invest in start-up businesses?

- Are the credit cards/debit cards offered by the institution being used to purchase legalized cannabis or being otherwise used in the operation of legalized marijuana activities?⁸

Answering these questions will assist in identifying the direct and indirect risks associated with the legalization of marijuana.

Banking Marijuana-Related Businesses

Best Practices and Industry Standards

Banks who maintain account relationships with marijuana-related businesses should enhance policies, procedures and monitoring controls to:

- Identify marijuana-related relationships at account opening.
- Evaluate and document the potential risks posed by marijuana dispensaries.
- Revise their AML program to address marijuana related businesses, including SAR policies and procedures addressing a three-tiered marijuana-specific reporting approach—"Marijuana Limited," "Marijuana Priority," and "Marijuana Termination." FIs that have policies or procedures surrounding account closures as a result of multiple SAR filings will need to update their policies to address exceptions for marijuana limited SARs.
- Maintain a "Marijuana Termination" SAR log and/or include as part of the 314(b) information sharing log documenting notification of the potential illegal activity to the second bank, as reasonably able, through secure 314(b) information sharing. The FI should maintain the date of notification, name of FI notified, contact person for the respective FI, customer name, nature of notification (i.e., marijuana termination SAR on potential new customer) and response date. If the bank does not participate in 314(b) sharing, documentation addressing the limitation of notifying the second bank should be noted on the log. Similar documentation process should be included for a FI that receives notification of a termination SAR through 314(b) information sharing; however, in addition the FI should document verification of the 314(b) participation and action taken on the information received.
- Ensure marijuana-related business relationships are appropriately considered within the bank's suspicious activity monitoring and other applicable reporting systems.
- Review and update the manual and/or automated transaction monitoring systems to ensure the thresholds or parameters have been set to assist in identifying or analyzing the red flags outlined in FIN-2014-G001.
- Treat marijuana dispensaries as an ineligible customer type for CTR exemptions, similar to ineligible businesses identified under (31 CFR 103.22(d) (5) (viii).

⁸ Protiviti. "Servicing Legalized Marijuana Businesses: Weighing the Risk in Light of the FinCEN guidance," (n.d). Robert Half, June 1, 2014 <http://www.protiviti.com/en-US/Documents/POV/Impact-of-Legalizing-Marijuana-on-AML-compliance-POV.pdf>

- Periodically scrub customer base names and addresses against a listing of approved marijuana dispensaries' names, owners and addresses to identify any potential unknown marijuana-related business accounts. This may be an effective control to implement regardless of the FIs' exposure to marijuana-related businesses.
- Perform a transaction volume and dollar comparison of all marijuana dispensary accounts in relation to other marijuana-related business accounts to identify any significant variances in business activity. This will also assist in establishing an understanding of normal and expected activity for marijuana dispensaries. The frequency can be established based on the bank's overall risk profile.
- Documented executive and board acknowledgment that they understand the risks associated with banking marijuana-related businesses and recognize that banking marijuana-related businesses currently violates federal law.
- The risk committee or board of directors should be made aware of key risk indicators related to the marijuana business-related accounts. Periodic reporting related to marijuana business accounts or related parties should consider SARs filed, accounts closed, CIP exceptions/violations, CTRs filed, 314(a) matches or 314(b) requests, and law enforcement requests.
- Consider allocating a compliance officer responsible for monitoring the marijuana-related businesses. The individual should have a thorough understanding of the specific state laws surrounding the legalization of marijuana and the federal law. The individual should be knowledgeable in AML/BSA laws, regulations and guidance, and privy to emerging trends and risks of illicit activity resulting from the legalization of marijuana.
- Update the AML/BSA training program to incorporate adequate coverage to address the bank's procedures and due diligence for servicing the marijuana industry, associated red flags and risks. The training should be tailored to the specific business lines.
- Continuously perform an Office of Foreign Asset Control (OFAC) scrub on the business and activity level.

Overall Program Risk Assessment

If a FI has a thorough understanding of the marijuana laws governing its state, has addressed balancing the profitability of banking marijuana-related business with the financial and reputational risk, and is going to proceed with offering financial services, the following should be considered when updating their program risk assessment:

- Address the legal, reputational, compliance, financial, geographic risk associated with banking marijuana-related businesses.
- Specifically evaluate the increase in third-party risk to address heightened regulatory expectations.
- Consider marijuana-related businesses as part of the high-risk customer base review. Perform an analysis of the number of customers considered a marijuana-related businesses and the number of accounts serviced and average dollar amount in relation to the entire customer base.
- Ensure the overall inherent risks of banking marijuana dispensaries are fully identified, risk rated and applicable red flags are included.

- Clearly define the mitigating controls and provide a detailed explanation of the residual risk such as addressing the EDD and CDD implemented to assist in mitigating the risk associated with banking marijuana dispensaries.

Customer Information Program (CIP) and Customer Due Diligence (CDD)

Bank management should perform a documented business and customer risk assessment on each marijuana dispensary that should be a composite of several factors to assist in identifying the level of risk presented. Several of the factors noted below align with the FFIEC BSA/AML Examination Manual⁹ for banking higher risk business entities:

- Anticipated account activities paying special attention to cash deposits, average amounts and frequency (consider requesting several months of prior bank statements)
- Source of funds and wealth
- Domicile (where the business is incorporated)
- Individuals with ownership and control over the marijuana related business and account (i.e., beneficial owners)
- Locations and markets served
- Geographic location of the business (Are international wires expected?)
- Purpose of the account
- Products and services offered
- Customer Base

Bank management should perform a documented business and customer risk assessment on each marijuana dispensary that should be a composite of several factors to assist in identifying the level of risk presented.

Enhanced Due Diligence (EDD)

In order to assist in mitigating the risk associated with banking marijuana-related business and performing adequate EDD, banks offering services to marijuana-related business should implement and maintain:

- Background checks of the marijuana dispensary, account holders and related individuals associated with the business. Related individuals may include board of directors, owners and business managers. More specifically, individuals with ownership or control over the accounts, such as beneficial owners should be taken into consideration.

⁹Board of Governors of the Federal Reserve System. Federal Financial Institutions Examination Council. FFIEC BSA/AML Examination Manual. 4/29/10.65

- Copies of all applicable state licenses. The bank may also consider obtaining any additional information related to the marijuana business such as the application, dispensary business plan, financial plan, corporate by-laws, financial statements and tax returns.
- Verification of the marijuana-related business' license and registration with appropriate state authorities.
- Confirmation of identifying information against public records.
- Review of the dispensaries' promotional materials, including its website, to determine target clientele to gain an increased understanding of products and services offered.
- Records of onsite visits. Onsite visits should be conducted immediately following account opening and performed periodically on an ongoing basis. The initial and ongoing onsite visit should be documented thoroughly. Review areas such as business locations, appropriateness of locations, products and services offered, customer base, inventory, signage and license, physical security, and address any positive or negative observations. Pay special attention to any unusual signage that may indicate alternate methods of payment, such as accepting virtual currency, prepaid card, and cashless ATM debit machines.
- Written policies and procedures from the marijuana-related business that address:
 - Employee screening process
 - Due Diligence standards for new customers
 - Filing a Form 8300 for receipt of \$10,000 or more in cash. Consider verifying existence of completed forms during an onsite visit.
 - Security
 - Process for purchasing marijuana if not grown by the dispensary
 - Documentation required by customers to determine medical validations
 - Record keeping of who in the dispensary sells the marijuana and how much they sell
 - Training
 - Compliance with regulatory requirements outlined by state and federal law
- The existence of a written AML/BSA program, including the designation of a compliance officer and contact information, internal policies, procedures and controls related to AML/BSA, CIP program, evidence of training to employees on AML/BSA laws and regulations including Form 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business), and independent testing and review. While not specifically required by law, development of these procedures shows good faith and best practices.
- Supporting documentation if the marijuana dispensary purchases its marijuana. The dispensary should identify all marijuana sellers and include information such as business name and other identifying information, principal business activity, and geographic location. Bank management should perform due diligence that is commensurate with the risk profile identified via the information obtained on the marijuana sellers.
- Adequate and ongoing due diligence documentation on marijuana dispensary relationships proportionate with the risk profile. Guidance suggests "refreshing information obtained as part of the customer due diligence on a periodic basis that is 'commensurate' with the risk."¹⁰ Industry standard typically defines periodic as at least annually; however, semi-annually or quarterly may be appropriate at least early in the customer relationship.

¹⁰ Department of Treasury. Financial Crimes Enforcement Network. FIN-2014-G001: BSA Expectations Regarding Marijuana-Related Businesses. February 14, 2014

- Ongoing due diligence documentation to ensure monitoring includes a detailed review of publically available resources for adverse information about business and related parties. The frequency of the review should align with the frequency of your other high-risk businesses.
- Confirmation that at least annually or as determined reasonable based on the commensurate risk, updates and validation of the information obtained during initial due diligence. This can be performed during the periodic onsite review. Items to consider are current licenses, any material changes in ownership, management structure, products or services, customer bases, etc. Consideration of these factors may also be considered if the marijuana dispensary opens a new account.
- Financial statements and tax returns of the business to accurately review the customer and determine if activity matches revenue.
- Evidence of consideration as to whether the customer's marijuana business activities breach any of the enforcement policies set forth by the by the Justice Department in a memorandum issued by Deputy Attorney General James Cole August 29, 2013 ("Cole Memorandum").

Cost Effectiveness

Enhancing an existing enterprise-wide risk management program and more specifically the current AML/BSA program to include AML safeguards and ongoing monitoring for marijuana-related business will impose an increased cost to FIs. As a result of the increased cost and potential impact on available resources, the FI could consider assessing a compliance monitoring fee and other deposit related fees to balance the time and resources needed to properly monitor its respective accounts.

Enhancing an existing enterprise-wide risk management program and more specifically the current AML/BSA program to include AML safeguards and ongoing monitoring for marijuana-related business will impose an increased cost to FIs.

However, FIs should recognize any fees assessed for maintaining a marijuana-related business will not offset the cost of potential penalties that may be assessed. Additionally, fee income may be considered deriving income and profits from illegal activity under federal law, consequently subjecting the bank to increased ramifications of willful violation. As the expectations and laws continue to evolve surrounding the legalization of marijuana at the federal level and the position of the banking regulators change, it may be more acceptable to assess fees.

Examiner Assessment

Paramount to all other steps mentioned above, FIs need to involve their regulatory examiners in the decision to bank marijuana businesses. In an interview conducted with Chuck Taylor, CAMS, senior vice

president and BSA officer of City National Bank, the following steps were mentioned to address balancing examiner perspectives and expectations of banking marijuana-related businesses:¹¹

- Contact the bank's examiner in charge and present the proposed enhancements to the AML/BSA program to address banking marijuana-related businesses. FIs should present their proposed policies and procedures to comply with the BSA as well as the FinCEN guidance and Cole Memo.
- Address what additional due diligence or program controls they would expect to see when performing a review of the files.
- As reasonably as possible, work towards an acknowledgement from the bank's federal regulator on the adequacy of the AML/BSA program established related to banking marijuana-related businesses.

Paramount to all other steps mentioned above, FIs need to involve their regulatory examiners in the decision to bank marijuana businesses.

Monitoring – Typologies and Patterns

In addition to the best practices, FIs should complete a documented review of their current automated transaction monitoring system to determine if the monitoring program established would assist in identifying potential suspicious activity. The monitoring program should identify both marijuana-related businesses, associated risks and emerging trends in illicit activity. FIs should address the adequacy of their surveillance monitoring, automated or manual, by identifying the red flags linked to marijuana businesses and align those risks to monitoring reports, rules, scenarios, thresholds, parameters or controls established within their suspicious activity monitoring program. FIs may reference the red flags issued by FinCEN as a starting point;¹² however, FIs should develop additional red flags beyond these. Further typologies and patterns to consider are third-party payments, out of demographic cash deposits, wire activity to high-risk geographies and non-business related transactions.

For instance, FinCEN identified a cash deposit followed by immediate cash withdrawals by a customer appearing to be using a state-license marijuana-related business as a potential red flag. FIs should review their thresholds and parameters to ensure their suspicious monitoring program would be reasonably able to identify cash deposits followed by immediate cash withdrawal, including geographical disparities indicative of funneling. More notably, if a rule based system is used, FIs should link rules or scenarios that would be used to identify the specific red flag and document any identifiable gaps or weaknesses.

¹¹ Taylor, Chuck. Senior Vice President & BSA Officer. Personal interview. June 13, 2014

¹² FIN-2014-G001. February 14, 2014

Compensating monitoring controls should be implemented to ensure red flags can be reasonably identified followed by a judgmental assessment of the probability and impact.

FIs should decide on the appropriate presentation and level of documentation based on the bank’s risk profile. Below offers an example for documentation:

Risk & Red Flag Description	Typology	Risk Mitigation/Controls/ Scenarios	Mitigate Type	Probability	Impact	Overall Risk (PXI)
Identify FinCEN red flags	Method used to launder proceeds	Corresponding Rules and scenarios	Automated/Manual	Possible	Moderate	Moderate

Regardless if the FI opts to bank marijuana related businesses or not, an assessment of emerging trends and associated risks resulting from the legalization of marijuana should be identified. FIs should following a similar process to ensure CDD, EDD, and suspicious activity monitoring are adequate.

Associated Risks

There are several patterns of activity that may be indicative of potential suspicious activity from marijuana-related businesses or other illicit activity that would impact FIs regardless if they are opting to offer marijuana-related businesses financial services. Patterns or activity could include the following:

Front/Shell Companies

An emerging trend and a specific red-flag identified within the FIN-2014-G001 guidance are for a marijuana-related business to establish front or holding companies when opening a bank account to conceal or disguise the involvement in marijuana-related business activity.¹³ FIs should review their CDD/EDD procedures and controls to ensure they can identify a potential front company. Case in point, a FI may consider conducting site reviews on businesses formed within the prior 12 to 18 months or located within an established mile radius of a known marijuana dispensary. In line with the FinCEN guidance, FIs may consider additional scrutiny on customers with a non-descript name like a “consulting,” “holding,” or “management” company that purports to engage in commercial activity unrelated to marijuana and deposits large amounts of cash.¹⁴

Business owners of front companies may create trust and investment accounts. Owners will provide an accountant with cash from the proceeds of cannabis sales and instruct the accountant to purchase shares in the name of the trust accounts or investment companies.

Establishing front companies are not just a method for properly registered and licensed marijuana businesses to seek access to financial services. Individuals tied to drug cartels and other illicit groups may

¹³ FIN-2014-G001. February 14, 2014

¹⁴ FIN-2014-G001. February 14, 2014

establish fictitious companies and use falsified documents to exploit weaknesses in FIs and traffic drug related proceeds.

Personal or Family Accounts

Business owners may use personal or family related bank accounts to facilitate the proceeds from the marijuana-related businesses. Owners may simply divide monies among several accounts in various other names or various accounts held at multiple FIs to conceal the nature of the funds, similar to smurfing. Undoubtedly having multiple bank accounts means a business owner can more easily deposit cash undetected. This makes it increasingly difficult for FIs to flag the activity. It also allows for continued behavior in the event one or more of the accounts is closed at another FI.¹⁵

Family members may be used as a conduit in concealing the funds. For instance, a family member may purchase a property financed with a mortgage. The mortgage would be held in the family member's name; however, the funds used to pay the mortgage would be derived from marijuana-related proceeds. The business owner or the family member would pay the mortgage using cash deposits. This is an example of purchasing high-value goods in the name of a third party to disguise the true ownership of assets.¹⁶

Tax Evasion

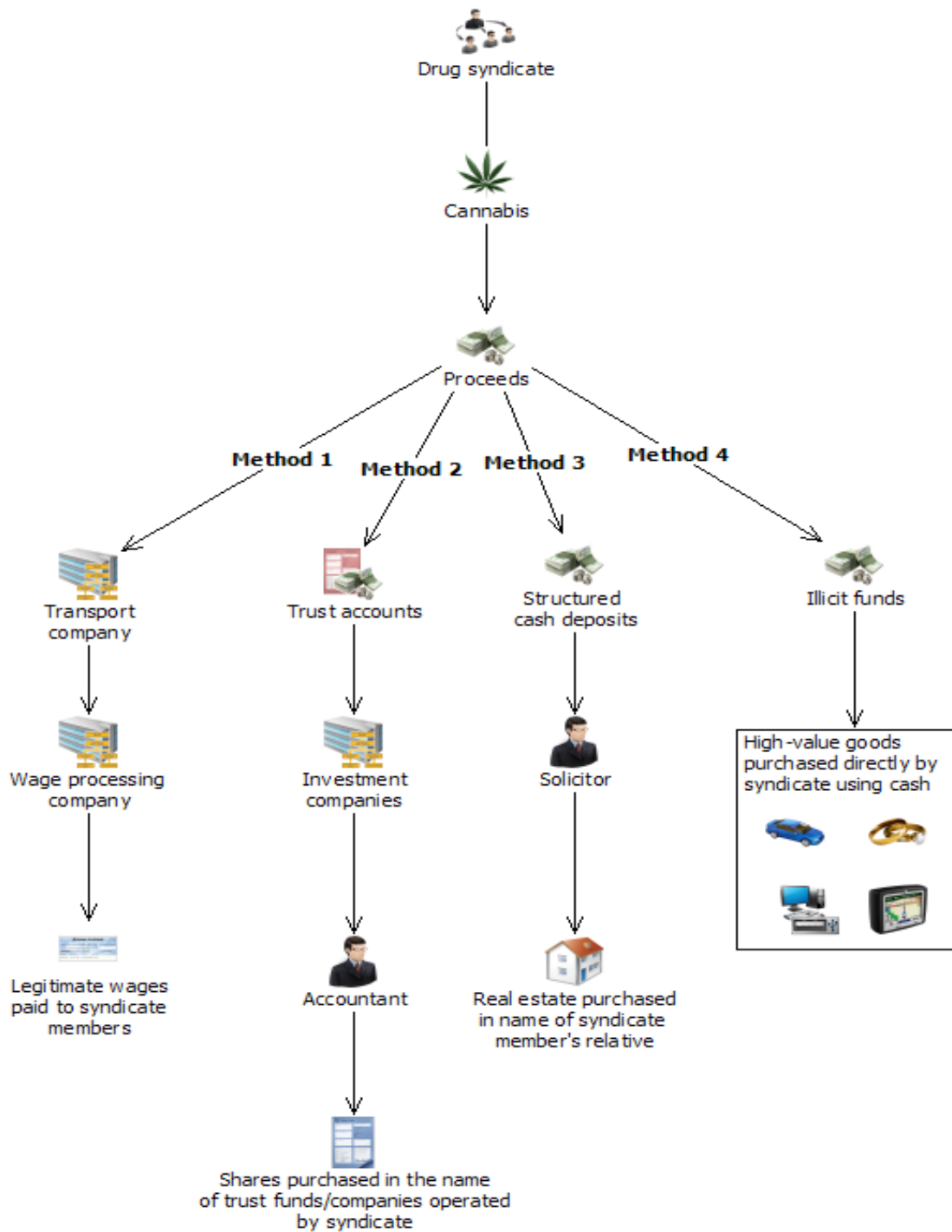
A strong motivation for states to legalize marijuana for recreational or medicinal use is partially based on the new tax revenue estimates. However, as a result of the inability for marijuana-related businesses to obtain financial services and inherently operating as all cash businesses, the risk for unreported and untaxed revenues greatly increases. This increase is attributed to the lack of transparency for tracking marijuana-related sales. In this situation, businesses will not have bank statements to allow for audits of revenues and deposits making it appealing to evade proper tax reporting ultimately resulting in sales not being inaccurately reported and lost tax revenue for states.

The following chart¹⁷ represents a visual depiction of several money laundering methods discussed above that could be used by a legitimate marijuana business or a business involved in the illicit trade of marijuana to facilitate funds through a FIs.

¹⁵ ,Kamin, Sam and Warner, Joel. *Your Money Stinks: Why banks won't do business with the marijuana industry* (And why it's a huge problem). (January 31, 2014). [Slate](http://www.slate.com/articles/news_and_politics/alterd_state/2014/01/colorado_marijuana_businesses_have_a_big_problem_banks_won_t_take_their.html) June 4, 2014
http://www.slate.com/articles/news_and_politics/alterd_state/2014/01/colorado_marijuana_businesses_have_a_big_problem_banks_won_t_take_their.html

¹⁶ Australian Government. Australian Transaction Reports and Analysis Centre. [AUSTRAC typologies and case studies report 2013](#). Australia: 2013

¹⁷ AUSTRAC 2013



Conclusion

As a result of the often slow timing by Congress to update federal law or provide a safe harbor protection, banks and marijuana businesses have sought other methods outside of the standard banking industry to accommodate operations such as:

- Virtual currency – Potcoin and DopeCoin
- Alternative banks/Co-Ops
- Cashless ATM debit machines and Point of Sale readers (including Square)
- Investment funds
- Prepaid and smart cards
- Financing companies – KindBanking

Alternative banking methods create larger scale problems, such as black markets, and augment the potential for illicit activity. This will increase the burden on already limited resources in law enforcement and FIs. Governance and oversight regarding compliance with AML laws, Financial Actions Task Force recommendations, and BSA will weaken as a multi-billion industry turns to alternative banking methods and underground markets not subject to adequate oversight by governing authorities. Regulations such as, but not limited to, CIP, FinCEN 314(a) and (b), EDD and OFAC are not adequately governed or required of these alternative banking avenues, which means compliance with applicable regulations could be weakened. Ultimately, in order for banks to become comfortable servicing marijuana businesses, the federal statute must be changed by Congress. Until then, FIs, legislators and law enforcement need to further collaborate in order to replace the traditional silos that have divided government, law enforcements, and FIs and replace it with partnerships working collectively to create effective and direct guidelines for a rising industry in its infancy.

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