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COMPLIANCE

Bank Supervision

Financial Industry Should Remain Cautious Despite Marijuana Banking Guidance



BY ZANE GILMER

The sale of medical or recreational marijuana is legal in at least twenty states and the District of Columbia. The sale of the drug generates a lot of cash. But banks have been reluctant to permit marijuana-related businesses to bank proceeds of marijuana sales or otherwise provide financial services to the marijuana industry. The reason is simple. Banks are concerned about running afoul of federal law, including the Bank Secrecy Act (“BSA”), which requires banks to monitor money passing through their institutions for potential money laundering activities.¹

To comply with the BSA, banks are required to file Suspicious Activity Reports (“SARs”) related to transactions they suspect involve potential money launder-

¹ 31 U.S.C. § 5311, *et seq.*; see also 18 U.S.C. §§ 1956 and 1957 (federal anti-money laundering statutes).

Zane Gilmer is a member of Perkins Coie LLP's Litigation Practice who works out of the firm's Denver Office. His practice focuses on business litigation, compliance and white collar defense and investigations.

ing.² Because the cultivation, possession, and distribution of marijuana are illegal under the federal Controlled Substances Act, any proceeds deriving from those transactions would be proceeds of an illegal transaction.³ Any marijuana-related business attempting to bank proceeds of marijuana sales would trigger the bank's obligation to file a SAR.⁴ Banks that fail to file a SAR for a reportable activity face criminal and civil fines and other penalties.⁵ Similar concerns have kept banks from extending loans to marijuana-related businesses and start-ups. Not only could such action be viewed as “aiding and abetting” a federal offense, but any collateral securing those loans could be subject to federal forfeiture laws.⁶ These, and many other issues have kept banks on the sidelines of pot commerce.

The marijuana industry's lack of access to banking means that marijuana-related businesses must operate on a “cash only” basis. Such operations are prime targets for robberies and other crimes. Federal authorities have taken notice of the public safety concern created by the marijuana industry's lack of banking access. Indeed, on Jan. 23 U.S. Attorney General Eric Holder Jr. publicly recognized these public safety concerns and

² 31 U.S.C. § 5311, *et seq.*

³ “Money laundering is the process by which one conceals the existence, illegal source, or illegal application of income, and disguises that income to make it appear legitimate.” *U.S. v. Shepard*, 396 F.3d 1116, 1120 (10th Cir. 2005).

⁴ 31 U.S.C. § 5311, *et seq.*

⁵ DOJ Press Rel. 12-1478: HSBC Holdings Plc. and HSBC Bank USA N.A. were fined \$1.256 billion and entered into a deferred prosecution agreement with the U.S. Department of Justice for violations of the Bank Secrecy Act. The violations resulted from HSBC's failure to maintain an effective anti-money laundering program to prevent, among other things, Mexican drug cartels from laundering drug proceeds through HSBC accounts, Dec. 11, 2012, available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

⁶ See *e.g.* 21 U.S.C. § 853 (criminal forfeiture statute related to controlled substance violations); 18 U.S.C. § 981, *et seq.* (civil forfeiture statute related to money laundering).

announced that the Department of Treasury and Department of Justice (“DOJ”) were working on guidelines to permit banks to conduct business with the marijuana industry in order to resolve the safety concerns.⁷

On Feb. 14 Treasury’s Financial Crimes Enforcement Network (“FinCEN”) and DOJ made good on Attorney General Holder’s promise by issuing separate guidance to financial institutions related to providing banking services to the marijuana industry.⁸ This article takes a closer look at the FinCEN and DOJ guidance and the myriad compliance issues that remain.

DOJ’s Guidance Sounds Loud Warning to Financial Industry

The DOJ guidance makes clear the provisions of the BSA, money laundering statutes and the unlicensed money remitter statute remain in effect with regard to marijuana-related conduct, despite efforts at the state level to legalize marijuana.⁹ The DOJ guidance advises that its prosecutors, in determining whether to initiate an investigation or to charge an individual or institution for a violation of one of those provisions related to marijuana conduct, should focus on the eight enforcement priorities DOJ set forth in its Aug. 29, 2013, memorandum.¹⁰ Those eight priorities are:

1. Preventing the distribution of marijuana to minors;
2. Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels;
3. Preventing the diversion of marijuana from states where it is legal under state law to other states;
4. Preventing state-authorized marijuana activity from serving as a pretext for trafficking other illegal drugs or other illegal activity;
5. Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
6. Preventing drugged driving and the exacerbation of other adverse public health issues related to marijuana;
7. Preventing the growing of marijuana on public lands and other public safety hazards associated with marijuana on public lands; and
8. Preventing marijuana possession or use on federal property.¹¹

DOJ’s guidance explains that a violation of one of its eight priorities may be ripe for investigation or prosecution, whereas a marijuana-related activity that does not

implicate one of those priorities *may not* be appropriate for prosecution.¹² Notably, DOJ’s guidance does not state that marijuana-related activities that steer clear of any of DOJ’s eight priorities will ensure a safe harbor from prosecution. Indeed, the guidance states quite the opposite. In what can be described as DOJ sounding the warning alarm for the financial industry, the guidance warns that “nothing herein precludes investigation or prosecution, even in the absence of any one of the factors listed above, in particular circumstances where investigation and prosecution otherwise serves an important federal interest,” and, perhaps more importantly, the memorandum does not provide “a legal defense to a violation of federal law.”¹³

Given DOJ’s warning that financial institutions cannot rely on the guidance as defense to prosecution for money laundering, the issued guidance should be looked at skeptically by the financial industry. Consider also that under the guidance, financial institutions are required to file SAR reports on all marijuana-related businesses (discussed below). In doing so, financial institutions are essentially admitting violations of the BSA and other anti-money laundering laws and simply hoping that federal authorities do not exercise their discretion to enforce federal law. If DOJ prosecutors or financial regulators ever decide to exercise their discretion and enforce the BSA and other anti-money laundering laws, the financial institution that filed the SAR is well positioned to be a target for prosecution.

FinCEN’s Guidance Provides Marijuana Banking Framework

FinCEN, for its part, issued much more tangible guidance for the financial industry. Indeed, FinCEN’s stated goals in issuing its guidance was to clarify BSA “expectations for financial institutions seeking to provide services to marijuana-related businesses” and to “enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses.”¹⁴ Despite those goals, however, the guidance is unlikely to ease the financial industry’s compliance concerns and provide widespread banking access to the marijuana industry.

Required Development, Implementation of Customer Due Diligence

FinCEN’s guidance provides that “the decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution.”¹⁵ To make these decisions, financial institutions are expected to develop and implement a thorough due diligence program that includes: (1) verifying with state authorities whether the marijuana-related business is licensed and registered; (2) reviewing (and presumably scrutinizing) the state application and supporting documentation submitted by the marijuana-related business to the state authorities in support of its marijuana application; (3) requesting from the state authorities infor-

⁷ Jack Healy and Matt Apuzzo, *Legal Marijuana Businesses Should Have Access to Banks, Holder Says*, The New York Times, Jan. 23, 2014, available at http://www.nytimes.com/2014/01/24/us/legal-marijuana-businesses-should-have-access-to-banks-holder-says.html?_r=0.

⁸ FinCEN Guidance, “BSA Expectations Regarding Marijuana-Related Businesses,” Feb. 14, 2014, available at http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf; James M. Cole, “Guidance Regarding Marijuana Related Financial Crimes,” U.S. Department of Justice, Feb. 14, 2014, available at <http://www.justice.gov/usao/co/news/2014/feb/DAG%20Memo%20-%20Guidance%20Regarding%20Marijuana%20Related%20Financial%20Crimes%20%2014%2014.pdf>.

⁹ DOJ Guidance, p. 2.

¹⁰ *Id.*; James M. Cole, “Guidance Regarding Marijuana Enforcement,” U.S. Department of Justice, Aug. 29, 2013, available at <http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>.

¹¹ DOJ Guidance, p. 1.

¹² *Id.* at p. 2.

¹³ *Id.* at p. 3.

¹⁴ Press release announcing FinCEN guidance, available at http://www.fincen.gov/news_room/nr/html/20140214.html.

¹⁵ FinCEN Guidance, p. 2.

mation related to the marijuana-related business and individuals involved with it; (4) developing an understanding of the marijuana-related business's "normal and expected activity," including the products it sells and types of customers it serves (i.e., recreational vs. medical); (5) ongoing monitoring of adverse public information concerning the marijuana-related business and related parties; (6) ongoing monitoring for any suspicious activity, including "red flags" described in the guidance; and (7) updating the due diligence information on a periodic basis and commensurate with the risk.¹⁶ As part of its due diligence program, the financial institution must consider whether the marijuana-related business implicates one of the eight DOJ priorities or violates state law.¹⁷

While the guidance outlines what a financial institution's due diligence program should include, it expressly states that it is not an exhaustive list. It is therefore up to the financial institution to develop and implement a due diligence program that will comply with the guidance. That is no easy task. Take, for example, the guidance's requirement for ongoing due diligence on a "periodic basis and commensurate with risk." The guidance provides no explanation as to how often the due diligence must be updated or to what extent.

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Further, the DOJ guidance suggests that if a financial institution is "willfully blind" to the fact that a customer is violating one of DOJ's eight priorities, then prosecution may be warranted. The guidance, however, does not indicate whether prosecution would be appropriate if the same financial institution used best efforts in conducting its customer due diligence, but a violation of one of the eight priorities still occurred. For instance, one of DOJ's priorities is to prevent drug proceeds from making their way into the hands of criminal enterprises, gangs and cartels. How can a financial institution ensure that a customer or related party is not associated with a criminal enterprise, gang or cartel? Would public records searches and background checks be sufficient due diligence to comply with the guidance? Even so, unless the individuals have a criminal record evidencing such associations, it is unlikely a financial institution can ensure the DOJ priority is not violated, even employing reasonable due diligence efforts.

¹⁶ *Id.* at pp. 2-3.

¹⁷ *Id.* at p. 3.

SARs for Marijuana-Related Businesses

If, after completing due diligence, the financial institution decides to provide financial services to the marijuana-related business the financial institution must file either a "Marijuana Limited" or a "Marijuana Priority" SAR. A Marijuana Limited SAR is required when the financial institution "reasonably believes," based on its due diligence, that the marijuana-related business does not implicate any of the eight DOJ priorities and is not in violation of state law.¹⁸ The information contained in the Marijuana Limited SAR is limited to: (1) identifying the subject and related parties to the transaction; (2) providing the addresses of the subject and related parties; (3) stating that the financial institution is filing the SAR solely because the subject is engaged in a marijuana-related business; and (4) stating that no additional suspicious activity has been identified.¹⁹

On the other hand, a financial institution must file a Marijuana Priority SAR if the financial institution reasonably believes, based on its due diligence, that the marijuana-related business violates one of the eight DOJ priorities or violates state law.²⁰ A Marijuana Priority SAR must include information typically included in other SARs, as well as (1) identifying information related to the subject and related parties; (2) addresses for the subject and related parties; (3) detailed information concerning the enforcement priorities the financial institution believes are implicated; and (4) details related to the transactions involved.²¹ According to the guidance, financial institutions must file a Marijuana Priority SAR even if it first filed a Marijuana Limited SAR, but later learns of information that implicates one of the eight DOJ priorities or a violation of state law.²²

If a financial institution provides financial services to a marijuana-related business and later decides to terminate that relationship due to money laundering concerns, it must file a "Marijuana Termination" SAR, detailing the basis for the termination.²³ Further, if the financial institution becomes aware that the marijuana-related business intends to move to a second financial institution, the original financial institution has an obligation to notify the second financial institutions of its concerns related to potential illegal activity.²⁴

To assist financial institutions in determining which SAR to file, the FinCEN guidance sets forth the following non-exhaustive list of 11 red flags that, if present, could mean that the marijuana-related business is violating one of the DOJ priorities or state law and the financial institution must follow-up:²⁵

- A marijuana-related customer appears to be using a state-licensed marijuana business as a pretext to launder money related to other criminal activity;
- The marijuana-related customer cannot produce sufficient documentation and other to demonstrate that

¹⁸ *Id.*

¹⁹ *Id.* at 4.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.* at 4-5.

²⁴ *Id.* at 5.

²⁵ *Id.* at 5-7.

it is duly licensed and operating consistent with state law;

- A marijuana-related business cannot demonstrate the legitimate source of significant outside investors;
- A customer appears to be disguising its involvement in the marijuana industry (e.g., by using non-descript business names);
- A review of publicly available information about the customer and related parties reveals negative information;
- The customer or related parties have been subject to state or local enforcement actions related to marijuana-related laws and regulations;
- The customer engages in international or interstate activity;
- The owners or related parties of the marijuana-related business reside outside of the state in which the marijuana-related business is located;
- A marijuana-related business is located on federal property or marijuana that is sold by the business was grown on federal property;
- A marijuana-related business's proximity to a school is not in compliance with state law; and
- A marijuana-related business purporting to be a "non-profit" is engaged in commercial activity inconsistent with its designation as a non-profit.²⁶

Filing marijuana-related SARs is not only an administrative burden on the financial industry, but it is a compliance trap. The determination as to whether to file a SAR and, if so, which one can mean running afoul of the guidance if the wrong determination is made. Further, assessing some of the red flags necessarily requires some subjectivity and judgment to be inserted into the decision-making process which opens the door for later criticisms and second guessing.

²⁶ *Id.*

Note to Readers

The editors of *Bloomberg BNA's Banking Report* invite the submission for publication of articles of interest to subscribers. Analyses, viewpoints, legal memoranda or other works are welcomed.

Queries should be directed to Assistant Managing Editor Joe Tinkelman, *Bloomberg BNA's Banking Report*, 1801 S. Bell St. Arlington, Va. 22202-4501; telephone (703) 341-5820; or e-mail jtinkelman@bna.com.

Beware of Indirect Participation

The guidance fails to address sufficiently what financial institutions' compliance obligations are related to providing banking services to non-marijuana-related businesses that, in turn, provide goods or services to marijuana-related businesses. The FinCEN guidance states that in those situations, financial institutions should use traditional reporting standards, but should also consider DOJ's eight priorities, where applicable, in determining whether to file a SAR.²⁷ Presumably, this means that in some instances, a financial institution may need to file a SAR (and perhaps a marijuana specific SAR) even if the banking services are provided to a non-marijuana related business. That could include any number of possible scenarios. Take, for instance, the hypothetical landlord that seeks to bank rent payments deriving from a marijuana-related business tenant. What due diligence or reporting requirements does a financial institution have related to banking those rent proceeds? What about the financial institution's compliance obligations concerning extending a loan to a small business that, in turn, uses those loan proceeds to provide consulting services to marijuana businesses among others? Given the myriad of non-marijuana industries that do, or could do, business with the marijuana industry, financial institutions must take efforts to implement thorough compliance and training policies to ensure compliance.

Compliance Pitfalls for Inadvertent Participation

The compliance issues facing the financial industry related to the legalization of marijuana is not just a concern for financial institutions interested in providing banking services to marijuana-related businesses. Indeed, it is not difficult to imagine a scenario in which a financial institution inadvertently provides financial services to a marijuana-related business. Although the services may have been provided inadvertently and despite well intentioned and implemented compliance protocols, that once non-participating financial institution is now a participating institution and is subject to the compliance and reporting requirements set forth in the guidance. To help ensure that such inadvertent participation does not occur, financial institutions must develop and implement thorough compliance policies and training procedures with the DOJ and FinCEN guidance in mind, to help ensure they do not inadvertently run afoul of the developing rules and regulations.

While federal guidance related to the intersection of the marijuana and financial industries was needed, the DOJ and FinCEN guidance fails to address all of the existing compliance issues. The guidance, however, made clear that both participating and non-participating financial institutions must seek experienced compliance counsel to help develop and implement thorough compliance procedures designed to navigate the marijuana industry's constantly evolving compliance traps.

²⁷ FinCEN Guidance, p. 4 n.7.