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# Insights

## Banking Marijuana-Related Businesses

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On March 21, 2018, Governor Holcomb signed a bill legalizing the sale and use of CBD oil in Indiana.[1] CBD oil is derived from industrial hemp, which like marijuana, is banned by federal law. This leaves Indiana's financial institutions asking: can we bank these businesses?

**The Legal Landscape**

Federal Law. Under federal law, the cultivation, production, sale and distribution of cannabis is illegal. The Controlled Substances Act[2] lists marijuana as a Schedule 1 controlled substance indicating that (A) marijuana has a high potential for abuse, (B) marijuana has no currently accepted medical use in treatment in the United States, and (C) there is a lack of accepted safety for use of the drug or other substance under medical supervision.[3]

The federal government often seizes personal and real property used in the cultivation, manufacture, sale and distribution of marijuana, even if such activities are legal under state law.[4]

State Law. Under state law, as of January 2018, adult recreational use of marijuana is legal in nine states (Alaska, California, Colorado, Maine, Massachusetts, Nevada, Oregon, Vermont and Washington state) and the District of Columbia. Medical use, first legalized in California in 1996,[5] is now permitted in an additional 21 states (Arizona, Arkansas, Connecticut, Delaware, Florida, Hawaii, Illinois, Louisiana, Maryland, Michigan, Minnesota, Montana, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, Rhode Island and West Virginia), Guam and Puerto Rico.[6] In Indiana medical cannabidiol (CBD) oil[7] was recently legalized.[8]

It should be noted that CBD and THC, the psychoactive component that delivers a "high," are completely different types of compounds found in cannabis. Hemp and marijuana are two different varieties of cannabis with the biggest difference being the varying levels of CBD and THC. Marijuana has higher levels of THC than hemp, and hemp has higher levels of CBD than marijuana. In order to be considered hemp, a cannabis plant must contain less than 0.3% of THC.[9] This explains the 0.3% THC threshold contained in the new Indiana CBD oil legislation which, as of July 1, 2018, will require retailers to label their products as such.

The Cole Memo. In 2012, when Washington and Colorado became the first states to legalize adult marijuana use, Assistant Attorney General James M. Cole responded by issuing a memorandum (the "Cole Memo") in which the Department of Justice outlined eight enforcement priorities:

- Prevent distribution of marijuana to minors
- Prevent marijuana revenue from funding criminal enterprises, gangs or cartels
- Prevent marijuana from moving out of states where it is legal

- Prevent use of state-legal marijuana sales as a cover for illegal activity
- Prevent violence and use of firearms in growing or distributing marijuana
- Prevent drugged driving or exacerbation of other adverse public health consequences associated with marijuana use
- Prevent growing marijuana on public lands
- Prevent marijuana possession or use on federal property.

Written between the lines of the Cole Memo was that the federal government would stay in abeyance so long as the states had sufficiently robust regulations to support control of licensure and regulation of these businesses.

Rohrabacher-Farr Amendment. Later that spring, Congress passed the Rohrabacher-Farr amendment.[10] Although it does not change the legal status of marijuana on the federal level, this legislation prohibits the Department of Justice ("DOJ") from spending funds to interfere with the states' implementation of their own state laws that authorize the use, distribution, possession or cultivation of medical marijuana.

The Rohrabacher-Farr amendment, which must be, and has been repeatedly, renewed each fiscal year, remains in place. Now known as the Rohrabacher-Blumenauer amendment, it was most recently renewed on March 23, 2018 as part of the omnibus spending bill and is in effect through September 2018. Thus, even if a federal prosecutor were to decide prosecution was warranted under the enforcement principles, the Department of Justice is prohibited from spending federal funds to proceed with any federal prosecution of a marijuana-related business.

The Sessions Memo. Attorney General Sessions rescinded the Cole Memo in a memorandum ("Sessions Memo") of his own issued on January 4, 2018.[11] This action was initially viewed as walking back the Obama-era policy of non-interference with marijuana-friendly state laws.[12] However, upon a closer reading, the Sessions Memo effectively reiterates the substance of the Cole Memo in that it states that in light of the "finite resources" available to fight crime, prosecutors should apply the same longstanding and well-established principles they have since those principles were first documented in 1980. In short, the Session Memo rescinds the Cole Memo explaining that given these principles, the Cole Memo was "unnecessary," but does not expressly state a policy of active enforcement of federal law against state-legal marijuana businesses.[13]

Thus, from all indications, rescission of the Cole Memo has not as a practical matter resulted in an increased threat that federal law enforcement is going to pursue marijuana-related businesses operating legally under state law and regulation.

**The Regulatory Landscape**

The Indiana Department of Financial Institutions ("DFI"). The Indiana DFI takes the position that if the customer is engaged in a business that is legal under Indiana law, an Indiana financial institution may provide financial services to that customer.[14] The Indiana DFI is cognizant that the activities of any marijuana-related business are illegal under federal law and encourages institutions to remain aware of this when performing both product and customer risk assessments.

Federal Reserve, FDIC and OCC. The federal regulators have not issued formal guidance on banking marijuana-related businesses. A recent panel of Federal Reserve, FDIC and OCC regulators has indicated that their policy is that they do not encourage or discourage banking marijuana-related businesses and that they will examine financial institutions that do so for compliance with the Cole Memo and FinCEN guidance (discussed below).[15] In addition, in meetings of the FDIC's Advisory Committee on Community Banking,

FDIC staff have acknowledged the illegality of marijuana on the federal level and its legality in some states and noted the FinCEN guidance that it is the financial institution's decision to open, close or refuse any particular account or relationship consistent with its internal risk management policies.[16] For financial institutions that choose to open an account or other relationship, FDIC staff have directed these institutions to the Cole Memo and FinCEN guidance regarding customer due diligence and the filing of suspicious activity reports.[17]

That said, the Federal Reserve Bank of Kansas City, after initially refusing, conditionally granted The Fourth Corner Credit Union a master account after the credit union revised its application and agreed that it would not serve marijuana-related businesses, but would serve ancillary business, i.e., those providing services to marijuana-related businesses.[18] Thus it appears that the position of the Federal Reserve may differ depending on district.

Financial Crimes Enforcement Network ("FinCEN"). Concurrently with the issuance of the Cole Memo, the Financial Crimes Enforcement Network issued its guidance "BSA Expectations Regarding Marijuana-Related Businesses" ("FinCEN Guidance")[19] This FinCEN Guidance clarified how financial institutions could provide services to marijuana-related businesses consistent with their Bank Secrecy Act[20] obligations and aligned the information provided by financial institutions in BSA reports with state and federal law enforcement priorities as outlined in the Cole Memo. FinCEN anticipated that the Guidance "should enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses."[21]

FinCEN does not address the legality of doing so under federal law, again as it is beyond the scope of its authority.

The FinCEN Guidance imposes a heavy, almost operationally prohibitive, burden on financial institutions that includes the elements of (1) a risk assessment, (2) special handling of suspicious activity reports ("SARs") and (3) currency transaction report ("CTR") handling.

With regard to the risk assessment, FinCEN requires a financial institution to assess the risk of providing services to a marijuana-related business including:

> (1) conducting customer due diligence that includes (a) verifying with state authorities whether the business is duly licensed and registered, (b) reviewing the license application and related documentation submitted by the business for obtaining a state license to operate its marijuana-related business; (c) requesting from state licensing and enforcement authorities available information about the business and related parties; (d) developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus recreational customers); (e) ongoing monitoring of publicly available sources for adverse information about the business and related parties; (f) ongoing monitoring for suspicious activity; and (g) refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk; and
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> (2) considering whether a marijuana-related business implicates one of the DOJ's enforcement priorities or violates state law. The FinCEN Guidance points out that this is a particularly important factor for a financial institution to consider when assessing the risk of providing financial services to a marijuana-related business because it enables the financial institution to provide information in BSA reports pertinent to law enforcement's priorities.

With regard to SARs, the obligation to file a SAR is unaffected by any state law that legalizes marijuana-related activity. A financial institution is required to file a SAR if, consistent with FinCEN regulations, the financial institution knows, suspects, or has reason to suspect that a transaction conducted or attempted by, at, or through the financial institution: (1) involves funds derived from illegal activity or is an attempt to disguise funds derived from illegal activity; (2) is designed to evade regulations promulgated under the BSA, or (3) lacks a

business or apparent lawful purpose.[22]

Because federal law prohibits the distribution and sale of marijuana, financial transactions involving a marijuana-related business would necessarily involve funds derived from illegal activity. Therefore, a financial institution is required to file a SAR on activity involving a marijuana-related business (including those duly licensed under state law), in accordance with the Guidance and FinCEN's suspicious activity reporting requirements and related thresholds. In addition FinCEN has defined three marijuana-specific filings: "marijuana limited", "marijuana priority" and "marijuana termination" filings.

*"Marijuana Limited" SAR Filings.* A financial institution providing financial services to a marijuana-related business that it reasonably believes, based on its customer due diligence, does not implicate one of the Cole Memo priorities or violate state law should file a "Marijuana Limited" SAR. The content of this SAR should be limited to the following information: (i) identifying information of the subject and related parties; (ii) addresses of the subject and related parties; (iii) the fact that the filing institution is filing the SAR solely because the subject is engaged in a marijuana-related business; and (iv) the fact that no additional suspicious activity has been identified. Financial institutions should use the term "MARIJUANA LIMITED" in the narrative section.

A financial institution should follow FinCEN's existing guidance on the timing of filing continuing activity reports for the same activity initially reported on a "Marijuana Limited" SAR.[6] The continuing activity report may contain the same limited content as the initial SAR, plus details about the amount of deposits, withdrawals, and transfers in the account since the last SAR. However, if, in the course of conducting customer due diligence (including ongoing monitoring for red flags), the financial institution detects changes in activity that potentially implicate one of the Cole Memo priorities or violate state law, the financial institution should file a "Marijuana Priority" SAR.

*"Marijuana Priority" SAR Filings.* A financial institution filing a SAR on a marijuana-related business that it reasonably believes, based on its customer due diligence, implicates one of the Cole Memo priorities or violates state law should file a "Marijuana Priority" SAR. The content of this SAR should include comprehensive detail in accordance with existing regulations and guidance. Details particularly relevant to law enforcement in this context include: (i) identifying information of the subject and related parties; (ii) addresses of the subject and related parties; (iii) details regarding the enforcement priorities the financial institution believes have been implicated; and (iv) dates, amounts, and other relevant details of financial transactions involved in the suspicious activity.[7]

*"Marijuana Termination" SAR Filing.* If a financial institution deems it necessary to terminate a relationship with a marijuana-related business 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. To the extent the financial institution becomes aware that the marijuana-related business seeks to move to a second financial institution, FinCEN urges the first institution to use Section 314(b) voluntary information sharing (if it qualifies) to alert the second financial institution of potential illegal activity.[8]

*Red Flags to Distinguish Priority SARs.* The FinCEN Guidance provides a long list of red flags that could indicate that a marijuana-related business is engaged in activity that implicates one of the Cole Memo priorities or violates state law. This list is not exhaustive. Financial institutions are directed to evaluate any red flags in the context of other indicators and facts, such as the financial institution's knowledge about the underlying parties obtained through its customer due diligence. Further, the presence of any of these red flags in a given transaction or business arrangement may indicate a need for additional due diligence, which could include seeking information from other involved financial institutions under Section 314(b). The list of red flags includes:

- 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.

- 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).

## Currency Transaction Reports (CTR) and Form 8300's

With regard to CTRs, financial institutions must report currency transactions in connection with marijuana-related businesses the same as they would in any other context, consistent with existing regulations and with the same thresholds that apply. A marijuana-related business may not be treated as a non-listed business under 31 C.F.R. § 1020.315(e)(8), and therefore, is not eligible for consideration for an exemption with respect to a financial institution's CTR obligations under 31 C.F.R. § 1020.315(b)(6).

## The Banking Dilemma

This confluence and inconsistency of federal and state law and regulation regarding the legality of marijuana presents a problem for the marijuana industry and for financial institutions. While selling CBD oil that does not exceed statutorily prescribed level of THC does not pose a risk under Indiana law, financial institutions with federal charters or access to the Federal Reserve's payment system technically violate federal law when they process transactions involving or take payments for loans made from the proceeds from the sale of CBD oil legal under state law.

Further while the risk of being found in violation of federal law may be low and despite the FinCEN Guidance on how to bank the marijuana industry, the operational burden of doing so and the risk of personal and real property collateral forfeiture has caused most financial institutions to decline to offer banking services or financing to marijuana-related businesses.

As a consequence, the multibillion-dollar marijuana industry is left with two unsatisfactory options for banking services: (1) operate solely in cash, which makes everyday business transactions unwieldy—handing out cash to employees on payday and to pay vendors and using Brinks to deliver your tax payments to the IRS—and dangerous with all of that cash making the business and its employees targets of crime, or (2) obtain banking services under false pretenses and hope the bank does not shut down your account upon discovery of the true nature of business being banked. For financing, the industry is turning to private investment.

A resolution to this dilemma is not imminent. However, legislative relief is an increasingly likely possibility: although not anticipated to pass, bipartisan federal legislation has been introduced that would enable businesses operating in states that have legalized marijuana to access the financial system.[23] While the momentum in state law and in the proliferation of marijuana-related businesses is clear, until such time as there is legal clarity, financial institutions are left to decide whether the opportunity is worth the risk.

[1] *See* iga.in.gov/legislative/2018/bills/senate/52#document-6a10d13; "Governor Signs Bill Making CBD Oil Legal in Indiana, https://www.wthr.com/article/governor-signs-bill-making-cbd-oil-legal-in-indiana (Mar. 21, 2018).

[2] 21 USC §§ 801-904 (2012)

[3] 21 USC §§ 802(6), 812 (Schedule I(c)(10)(2012).

[4] *See* 21 USC § 881; 18 USC §983 and § 985.

[5] See Compassionate Use Act of 1996, California Health & Safety Code § 11362.5 (1996).

[6] *See* National Conference of State Legislatures, "State Medical Marijuana Laws" http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx (June 27, 2018).

[7] CBD oil is made from high-CBD, low-THC hemp, unlike medical marijuana products, which are usually made from plants with high concentrations of THC. Because hemp contains only trace amounts of THC, these hemp oil products are non-psychoactive. *See* https://www.medicalmarijuanainc.com/cbd (What is CBD oil?)

[8] *See* Act of March 21, 2018, SEA No. 52, Sec. 9, Pub. L. 153 (codified at IC 24-4-21).

[9] *See* https://madebyhemp.com/does-cbd-have-thc/.

[10] *See* H.Amdt.748 to H.R.4660 – 113th Congress (2013-2014); https://congress.gov/amendment/113th-congress/house-amendment/748/text.

[11] Jefferson B. Sessions, III, Attorney General, Memorandum for all United States Attorneys; Marijuana Enforcement (Jan. 4, 2018), https://www.justice.gov/opa/press-release/file/1022196.

[12] *See* Laura Jarrett, Sessions nixes Obama-era rules leaving states alone that legalize pot, CNN (Jan 4, 2018), https://www.cnn.com/2018/01/04/politics/jeff-sessions-cole-memo/index.html.

[13] Jefferson B. Sessions, III, Attorney Gen., Memorandum for all United States Attorneys; Marijuana Enforcement (Jan. 4, 2018), https://www.justice.gov/opa/press-release/file/1022196.

[14] Interview with Thomas Fite, Director, Indiana Department of Financial Institutions (May 3, 2018).

[15] *See* "Ask the Experts: 10 Questions on Banking MRBs," Banker's Toolbox (May 31, 2018), https://www.bankerstoolbox.com/news/blog/top-ten-questions-banking-mrbs/.

[16] *See* Minutes of The Meeting of the Advisory Committee on Community Banking of the Federal Deposit Insurance Corporation Held in the Board Room Federal Deposit Insurance Corporation Building, Washington, D.C. 251, 264-266 (Apr. 9, 2014); *see also* Minutes of The Meeting of the Advisory Committee on Community Banking of the Federal Deposit Insurance Corporation Held in the Board Room Federal Deposit Insurance Corporation Building, Washington, D.C. 402, 417 (Nov. 3, 2016).

[17] *See* Minutes of The Meeting of the Advisory Committee on Community Banking of the Federal Deposit Insurance Corporation Held in the Board Room Federal Deposit Insurance Corporation Building, Washington, D.C. 251, 264-265 (Apr. 9, 2014).

[18] Letter from Susan E. Zubradt, Federal Reserve Bank of Kansas City, to Dierdra O'Gorman and Christopher E Nevitt (Feb.2, 2018).

[19] BSA Expectations Regarding Marijuana-Related Businesses, FIN-2014-G001 (Feb. 14, 2014), www.fincen.gov/statutes-regulations/guidance/bsa-expectatinos-regarding-marijuana-related-businesses.

[20] 31 USC § 5311 (2001).

[21]*Id*.

[22] *See, e.g.*, 31 CFR § 1020.320 (2011). Financial institutions shall file with FinCEN, to the extent and in the manner required, a report of any suspicious transaction relevant to a possible violation of law or regulation. A financial institution may also file with FinCEN a SAR with respect to any suspicious transaction that it believes is relevant to the possible violation of any law or regulation but whose reporting is not required by FinCEN regulations.

[23] *See* Neil Haggerty, Warren floats pot banking bill to help states circumvent federal ban, American Banker (June 7, 2018), https://www.americanbanker.com/news/elizabeth-warren-floats-pot-banking-bill-to-help-states-circumvent-federal-ban.