GROWING CONCERNS

COMMUNITY INSTITUTIONS HAVE LONG BEEN SEEN AS A NATURAL PARTNER TO SMALL BUSINESS. BUT WHEN THE BUSINESS IN QUESTION IS SELLING MARIJUANA, REGULATORY AND REPUTATIONAL CONCERNS HAVE CAUSED MANY INSTITUTIONS TO STEER CLEAR.

Last year, the marijuana industry racked up $6.7 billion in sales, according to market research, and was projected to create more jobs than manufacturing. Legal for adult recreational use in eight states and medicinal use in many more, decriminalization has been a powerful trend over the past several years.

With such impressive growth, one might assume that community institutions would be lining up to provide banking services to these booming businesses. However, this has not been the case thus far – and we may yet be far from a turning of the tide.

REGULATORY HURDLES

"You have to start from the understanding that it's still illegal under federal law," says attorney John Geiringer, a partner in the Financial Institutions Group at Barack Ferrazzano. "That's the starting point that every institution has to grapple with."

Indeed, as of this writing, marijuana remains a Schedule 1 drug, which means the FDA deems it high risk with no medical benefit – a classification shared by heroin (even cocaine and meth have some accepted medicinal uses that relegate them to the less severe classification of Schedule 2). Further, under the new administration, it's possible that the trend toward legalization could be slowing down. U.S. Attorney General Jeff Sessions once remarked that "good people don't smoke marijuana," and he has been adamant in noting his plans to use his elevated role to work toward rolling back the Rohrabacher-Farr amendment, which allows states to make their own decision whether or not to legalize marijuana without interference from the Justice Department.

Nevertheless, marijuana remains a growing business at this point. But when it comes to providing banking services to companies in the industry, institutions in marijuana-friendly states face the challenge of navigating this space between a state-legal marijuana business and a federally-illegal marijuana product.

"FinCEN and the Department of Justice put out a road map [on how institutions] can provide services to these entities and not violate the BSA, but when you dig into the guidance, it's really hard to jump through all of the hoops," says John Zasada, a principal and leader of the regulatory compliance practice at CliftonLarsonAllen. "When it comes down to it, even apart from the current administration, there are many experts that feel like there's really no way to totally reduce your risk in being able to comply with that guidance."

In light of the guidance available, institutions are understandably reluctant to take on clients associated with the marijuana industry even in states where it's legal. Some may take on these clients, but have them keep the nature of their business under the table and out of the spotlight. However, in such a cash-heavy industry, the truth tends to surface and accounts are often shut down and relationships ended.

"One retail owner has had her account shut down seventeen times, and she's on the side of compliance and disclosure, but she runs into these problems constantly," says Beau Whitney, an economist who has conducted in-depth research into the field of recreational marijuana legalization. "I think the difficulty is that the Feds are saying you can provide banking services to a Schedule 1-related company, but you have to do X, Y and Z in order to do so. So there's a fair amount of risk associated with it, and it becomes fairly costly."

But there are risks with not being banked as well. In a booming, cash-intensive business, not having access to banking services tends to become a safety issue, both for those within the marijuana industry and for their surrounding communities.

"When you have this business that's operating almost entirely in cash, there are community-based risks," says Zasada. "It's just not the safest way for money to be handled, and it'd be best if a federally insured institution was involved."

OPERATIONAL CHALLENGES

While institutions taking on marijuana businesses may struggle to comply with not only FinCEN and DOJ guidance, Zasada says third-party firms grading on compliance have a particularly difficult time giving the all-clear on the Cole Memorandum, which says that banks have to ensure that their marijuana-based clients don't promote negative societal effects such as contributions to cartels, distribution to minors or exacerbation of drugged driving.

> "Every bank has to conduct its own risk analysis with respect to any new product or service they may provide. Marijuana's no different."
>
> John Geiringer, Partner, Barack Ferrazzano

This means that institutions not only need to vet their clients, but to some degree their clients' clients – a level of compliance that makes many experts believe there's no real way to totally reduce the risk.

Even if an institution does all of its homework, a well-planned decision to work with marijuana entities is often still at the mercy of a correspondent banks' oversight. Correspondent banks often don't want their downstream banks engaged in what they perceive as a risky endeavor, regardless of the precautions those institutions may have taken.

"They can always get another correspondent bank, but those relationships are very sticky and banks are disinclined to leave a correspondent bank over this issue," says Geiringer.

Then there are the potential public relations implications of taking on clients dealing in a federally illegal product. While the complicated SARs associated with such a cash-heavy industry might stand out initially as the biggest issue to consider, one of the commonly cited problems for many institutions is much more on the nose – quite simply, those big cash deposits coming from marijuana businesses can smell up a branch office. Some institutions have gone so far as to have a special room to deal with the cash from marijuana businesses in order to cope with the optics (or odor, in this case).

Other PR issues have less to do with the legality of the product, but rather the challenge of working with an industry that many regulators just don't like, similar to the fraught relationship institutions have had with payday lenders due to government and regulatory pressure. While it might not necessarily take a Schedule 1 drug to make banking a particular business difficult, it definitely doesn't help.

"There are plenty of industries banks treat like this, either because they themselves find it risky, or they've seen how regulators have signaled that they could be problematic," Geiringer says.

NAVIGATING COMPLIANCE

Despite the many potential challenges, there are institutions that bank marijuana-related businesses – and do it well. Among other considerations, two of the necessary tools to have before wading in are an in-depth understanding of all relevant regulatory guidance and the right team. For example, an experienced and savvy BSA/AML staff will be familiar with the enhanced due diligence required for riskier customers, and be able to appease regulators by automatically treating marijuana clients as enhanced due diligence customers.

"I tell any bank that wants to engage in marijuana-related activities that they need to have a top-notch compliance staff and a top-notch BSA/AML staff in place before they go down that road," Geiringer says. "Often it's not the marijuana that concerns the regulators as much as the fact that the bank didn't have the BSA/AML architecture in place to handle customers who require more enhanced due diligence in the first place."

In fact, some institutions that have chosen to go down the marijuana road will opt to confine their marijuana-related activities to one specialized branch, with all marijuana clients working through that one location. Not only does this strategy make practical sense when it comes to having one sorting room as opposed to trying to find a space for it in every branch, but the institution can also focus specialized personnel and expertise in that one location. Even within the world of marijuana clients, however, some require more involvement than others. The closer the business is to touching the actual marijuana plant, the more compliance you'll need.

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"The institutions that do it well can get away with charging these customers a lot more to recoup some of their compliance costs," Geiringer notes.

However, Whitney warns against pricing marijuana companies out of business, stressing that building a better relationship can lead to a happy medium that will prove beneficial to both the institution and the client. Asking the businesses to provide thorough documentation up front and in-depth updates on an ongoing basis is essential.

"By becoming better partners with them, they'll eventually learn how to self-regulate," he says. "What's common in Oregon is submitting the same documentation the business needs to get a state license – ownership structure, source of funds, use of funds, location, security, tracking – so the financial institution can get that in their systems and application file and see that they're legit." Of course, building relationships with regulators and law enforcement is equally important, allowing the institution to more easily reach out as questions or situations develop. Regulators are more likely to see banking marijuana businesses as a compliance issue than a law enforcement issue – and they know the implications of having so much unbanked cash.

"There's a good synergy between divisions within the government on a state level, where they understand not just the banking regulations but also the seed-to-sale regulations on the marijuana side," Geiringer notes.

THE BOTTOM LINE

Looking at an infant industry with shaky legal footing, Geiringer says there's every reason for community institutions to exercise caution when considering taking on a marijuana banking client. But for those institutions with solid due diligence and the right protocols in place, he also believes there are a lot of reasons – beyond the money – to start thinking seriously about it.

"There are some institutions that have top-of-the-line compliance and top-of-the-line BSA/AML who are willing to invest, aren't afraid of the public relations ramifications and who will say 'if they're a legal business, we're going to bank them,'" he says.

Even so, he's quick to point out that it's still not right for everyone – especially those not willing to make the commitment needed to do it right.

"You don't want to dabble in the marijuana space."

forward, a publication of the Financial Managers Society
Published for:
Financial Managers Society, Inc.
1 North LaSalle Street | Suite 3100
Chicago, IL 60602-4003
FMSinc.org | 800-ASK-4FMS

SOWING THE SEEDS

When asked what the future holds for the marijuana industry – and its intersection with banking – our three industry experts had a few thoughts to share.

GETTING BIGGER

"That $6 billion sales figure is going to rapidly increase over the next few years as the newly established recreational markets start making sales," Whitney says. "The cash-strapped states are seeing the revenue generated from legalization, and not seeing the adverse impacts that a lot of the opponents of legalization have talked about."

"Predicting what this administration will do can be a difficult thing, but I do think it will be hard to put the genie back in the bottle," Geiringer adds.

STATES TAKE THE LEAD

States are spearheading ways to make the marijuana industry safer and the regulations that surround it clearer. In Oregon, Nevada and Colorado, for example, companies are testing closed-loop systems such as kiosks in order to ensure that inordinate amounts of cash aren't floating around.

BANKING SERVICES NEEDED

Legislation is beginning to be introduced to address the issue of institutions being uncomfortable banking marijuana businesses, which are badly in need of their services.

"One would think – outside of what's happening in the administration – we are certainly on a trend towards making it easier to bank marijuana businesses, undeniably," Zasada says. "If there was a clear way to legally provide services to these entities, I don't think they would have any trouble finding a financial institution in their community."