

# ARKANSAS A COMMUNITY BANKER

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# Banking with Marijuana Related Businesses: A Different Perspective

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Since “The Arkansas Medical Marijuana Amendment of 2016” was approved last November, it has received a pessimistic reaction in the Arkansas banking community due to the risks associated with providing banking services to marijuana related businesses (“MRBs”).

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Most notably, marijuana is still illegal under federal law. Still, several financial institutions in other states where marijuana is legal for either medical or recreational use have started doing business with MRBs despite the risks. With this in mind, Arkansas banks should consider the potential financial and social benefits of working with MRBs and ways that they can reduce the associated risks before rejecting the idea.

### ***The Case For Providing Banking Services To Marijuana Related Businesses***

The number of financial institutions providing banking services to MRBs is steadily increasing. It is likely financial institutions are motivated by the financial gains derived from charging fees for account origination and maintenance and individual transactions related to MRB accounts. The services are typically limited to basic checking; financial institutions are leery of lending to or leveraging money from MRBs because of a lack of federal guidance and the risk that the collateral on secured loans may be subject to forfeiture. While there is little to no verifiable data about the amount of revenue generated from servicing MRBs, it is safe to say that it is significant enough to make the risks palatable.

Although financial incentives may be the primary motive to offer banking services to MRBs, offering such services also provides value to the entire state of Arkansas. First, operating an exclusive cash industry poses a risk to public safety. Projections estimate that sales of medical marijuana could range between \$30 to \$60 million dollars. This means that medical marijuana dispensaries will have large amounts of cash on hand with no place to deposit the funds, making them prime targets for robbery attempts. Arkansas revenue offices may also be targets for robberies because, without banking services, MRBs will

be required to pay their state taxes in millions of dollars of cash. Access to banking services, including electronic banking, will significantly reduce the amount of cash on hand and allow MRBs to operate in a more secure manner, ultimately making MRBs and their surrounding communities safer.

Second, access to banking services will allow the State of Arkansas to accurately track the revenue generated by MRBs. In a cash only industry, revenue reported does not always match revenue received. It is important that MRBs are accurately reporting revenue as it maintains the legitimacy of the state-regulated industry and ensures the state realizes the appropriate tax revenue. The Arkansas tax revenue is currently slated to help support a number of state entities and funds.

### ***Risks Inherent To Providing Banking Services To Marijuana Related Businesses***

- **Risk Of Prosecution For Violating Federal Law**  
Financial institutions risk violating federal laws and regulations if they offer banking services to MRBs. There are various statutes implicated in this type of endeavor, but the statutes most likely to create issues for financial institutions are the Bank Secrecy Act (“BSA”) and Money Laundering Control Act (“MLCA”). BSA requires financial institutions to file reports of banking transactions that may indicate criminal activity. MLCA established money laundering as a federal crime punishable by imprisonment and civil and criminal forfeiture for BSA violations. MLCA also requires financial institutions to create and maintain anti-money laundering procedures (“AMLs”) to monitor compliance with BSA in an effort to prevent money laundering.

Some commentators have suggested that the United States Congress, by passing the Consolidated Appropriations Act of 2016, protected financial institutions who do business with MRBs from federal enforcement actions. The Act includes an appropriations rider that prohibits the use of United States Department of Justice (“DOJ”) funds to prevent the implementation of state laws that authorize the use, distribution, possession, or cultivation of medical marijuana with respect to 40 states, the District of Columbia, and two territories. The 9th Circuit Court of Appeals has provided some comfort to MRBs by holding that the appropriations rider prohibits the DOJ from prosecuting individuals that comply with state-medical-marijuana law under the CSA. *U.S. v. McIntosh*, 833 F.3d 1163 (9th Cir. 2016).

It is unlikely, however, that the appropriation rider applies to financial institutions that work with MRBs because most, if not all, medical marijuana laws do not address banking services, and the 9th Circuit limited the application of its decision to DOJ actions that have the “practical effect” of preventing states from implementing their medical marijuana laws. While it is undisputed that a lack of banking services has been a hindrance to the medical marijuana industry, it has not prevented states from successfully regulating the industry. Thus, for the 9th Circuit’s reasoning to offer any potential relief to Arkansas financial institutions, the state’s medical marijuana regulations should not only address cultivators and distributors but also the need for banking services. Further, the appropriations rider needs to be extended, as it is set to expire in April of this year, and amended to include Arkansas for it to have any applicability.

#### • **Risk Of Regulatory Action**

Regulators of financial institutions pose an even bigger risk to doing business with MRBs. Both the Federal Reserve and the FDIC are independent and uncontrolled by the executive branch and have the power to impose Prompt Corrective Action against financial institutions that work with MRBs. Prompt Corrective Action includes civil penalties, fines, cease and desist orders, and lifetime bans of bankers. Any financial institution that connects to the payment system is subject to the federal laws and regulations those agencies have a duty to enforce.

Financial institutions should also be cognizant that the posture the new administration takes on the issue of medical marijuana will affect the level of risk connected with servicing MRBs.

#### **Ways to Manage Risks Associated With Providing Banking Services To Marijuana Related Businesses**

Unlike traditional banking relationships that impose strict privacy obligations, the relationship between financial institutions and MRBs requires transparency with the federal government in order to mitigate exposure to risk.

#### • **Compliance With Guidance From The Federal Government**

Under the Controlled Substances Act (“CSA”), it is illegal to manufacture, distribute, or dispense marijuana. In 2013, the DOJ issued a memorandum, commonly known as the “Cole Memo”, in which the DOJ provided guidance to federal prosecutors and law enforcement agencies related to marijuana enforcement under the CSA. The Cole Memo directs federal prosecutors and law enforcement to use their limited resources to focus on eight enforcement priorities. Those priorities include:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;

- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and 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 on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

In 2014, the Financial Crimes Enforcement Network (“FinCEN”), a bureau of the U.S. Department of Treasury charged with safeguarding the financial system from illicit use, issued its own guidance to financial institutions seeking to provide services to MRBs. FinCEN outlined how financial institutions, in working with MRBs, could fulfill their duties under the BSA and comply with the Cole Memo priorities. The guidance aimed to “enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses.” The guidance set forth due diligence requirements for opening and maintaining MRB accounts. The requisite due diligence includes: (i) verifying with the appropriate state authorities whether the business is duly licensed and registered; (ii) reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business; (iii) requesting from state licensing and enforcement authorities available information about the business and related parties; (iv) 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; (v) ongoing monitoring of publicly available sources for adverse information about the business and related parties; (vi) ongoing monitoring for suspicious activity, including for any of the red flags described in the guidance; and (vii) refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.

The guidance also created criteria for filing Suspicious Activity Reports (“SARs”) in relation to servicing MRBs and BSA compliance. All financial institutions are required to file SARs for any business or person it has reason to suspect, suspects, or knows to be engaged in an illegal activity under federal law. Institutions that knowingly work with MRBs must file SARs that place those businesses into three categories and use the following designations:

1. *Marijuana Limited* – any MRB the financial institution reasonably believes is not in violation of state law and does not implicate the Cole Memo.
2. *Marijuana Priority* – any MRB the financial institution reasonably believes is in violation of state law or

- implicates the Cole Memo
3. *Marijuana Termination* – any MRB the financial institution reasonably believes it must terminate its relations with to maintain an effective anti-money laundering compliance program

Additionally, in concurrence with FinCEN's guidance, the DOJ issued a supplement to the Cole Memo that reiterated the DOJ's enforcement priorities and its right to enforce federal laws related to marijuana.

The guidance offered by FinCEN and the DOJ provide confines in which the federal government has allowed financial institutions to service MRBs. Any financial institution that elects to do business with MRBs must comply with the guidance. While doing so is not a safe harbor from the risk associated with this line of business, there are no reported instances of adverse action by the DOJ or any other federal entity against a financial institution that complies with the guidance. Failing to comply with the guidance, on the other hand, is likely to result in civil and criminal prosecution. Compliance, however, is only a portion of the strategy financial institutions offering services to MRBs should implement.

- **Due Diligence**

Initial and continued due diligence is crucial to providing banking services to MRBs. Financial institutions that offer banking to MRBs have the right to choose which businesses they will and will not service. In making those determinations, they should have an in-depth knowledge of any potential MRB customer prior to issuance of an account. Specifically, knowledge of 1) the MRB's owners and key management and employees to ensure they meet the criteria necessary to own or work in a MRB, 2) whether the MRB has complied

with state licensing requirements, and 3) current and projected revenue, funding, solvency, and anticipated frequency of deposits and withdrawals to help monitor any red flags that may implicate the federal enforcement priorities. Financial institutions should also visit and inspect the MRB's place of business. Once an account is issued, a financial institution should routinely update its knowledge of the MRB and conduct periodic inspections. Simply put – know your customer and its business.

- **Working with Regulators & Prosecutors**

To mitigate the risks posed by regulatory agencies, financial institutions should form close working relationships with their regulators based upon transparency as it relates to MRBs. Additionally, financial institutions should ascertain the regulators expectations for reporting and compliance and request that those expectations be in writing. Financial institutions should also consult federal prosecutors to determine whether and under what circumstances working with an MRB may subject them to prosecution.

### **Conclusion**

If a financial institution in Arkansas wants to explore offering services to MRBs, it should assess the comprehensive benefits and risks associated with providing banking services to MRBs, be apprised of the applicable state and federal law and regulations, and seek guidance from its regulators and federal prosecutors. As evidenced by the increase of financial institutions that work with MRBs, there is opportunity for those willing to take the risk.

<sup>1</sup>Arkansas – which had not legalized marijuana in any form when the Act was passed – was also not included.



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