How to Bank Cannabis

A Compliance Guide for Financial Institutions

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There are now more than 28 states with some form of a legal cannabis or marijuana market, and more banking accounts for these types of businesses are opening everyday. The sheer size of this budding industry is immense given consumer demand for the product and its derivatives.

There are more than 12,500 operational marijuana business licenses in the United States. As some marijuana businesses have multiple licenses operating under one or more co-owned companies, it is estimated that there are approximately 5,000 single and multi-licensed marijuana businesses in operation today. Estimates for legal marijuana sales in the United States are expected to exceed $20 billion by 2020.

As the chart below highlights, many institutions are providing banking services to businesses related to cannabis or marijuana.

![Chart showing Depository Institutions (by type) Providing Banking Services to Marijuana Related Businesses (Data ending 31 March 2017)](source: FinCEN Marijuana Banking Update - June 2017)
National or multi-state (interstate) banks have shied away from banking marijuana due to current federal guidance and deposit insurance requirements. This massive void is filled by local or private banks and credit unions. Adherence has assisted banks in writing clarification letters to the Federal Reserve branches in order to gain insight on operational requirements.

To address “Know Your Customer” (KYC) requirements, an institution should implement a process to verify its marijuana account holders. A customer identification program (CIP) establishes the expectation and monitoring of customer behavior. A risk management program for marijuana accounts should include enhanced due diligence (EDD) to detect and report on possible money laundering. In order to be effective, the bank’s programs must ensure inventory diversion does not occur and that overall compliance, not just financial compliance, is routinely inspected, reviewed and assessed. The process can be very complex without an understanding of the various levels and categories of compliance in the marijuana industry.

**Number of Depository Institutions Actively Banking Marijuana Businesses in the United States (Reported in SARs)**

Source: FinCEN Marijuana Banking Update - June 2017
Marijuana Banking Compliance Framework
For banks or credit unions considering entering this space, the concept can be overwhelming. In evaluating the implementation of a compliant marijuana banking program, an institution needs to evaluate multiple of levels of regulatory and financial compliance.

Some banks will allow pre-revenue marijuana businesses to open an investment or deposit account to raise funds for a licensed operation. Once revenue is derived from the plant or associated products, the account is transitioned to an operating or current account.

High-Risk Portfolios
Most banks cannot exceed a 10% threshold on high-risk operating accounts in terms of overall deposits, meaning any small bank or credit union would have a limit on the number of operating accounts they could open in a given market or state.

Four (4) Levels of Regulatory Compliance
An operational marijuana license is the privilege to sell, cultivate, manufacture, distribute or test marijuana or marijuana derived products. On top of the financial requirements related to AML, BSA, Cole Memo, FinCEN and more, marijuana businesses must also be compliant with the following regulatory levels:

• Federal
• State
• County
• City

Federal, State & Local Agencies
Even though marijuana businesses are not supported or recognized federally, each one must adhere to all federal requirements and related regulatory agencies, such as the IRS, OSHA, EPA, Agriculture, Labor and other agencies.

Each state, city and county where marijuana sales are legal generate regulatory code and statutes to govern and tax production and sales. Some states have implemented more than 400 pages of regulatory code governing legal marijuana operations.
Looking forward, sales (inventory) may be taxed at all four levels and could impact deposits, receipts, chain-of-custody requirements, transport, business records retention requirements and other compliance areas. The regulatory scrutiny in the marijuana industry is on-par with the health care, gaming and other high-risk industries.

**Marijuana Banking Compliance Framework**

After working with banks since 2014, Adherence has developed the following five-step process for an enhanced due diligence cannabis banking program framework:

1. Application processing, screening & acceptance
2. Account setup & reporting
3. Routine compliance monitoring
4. Secure cash management & deposit verification
5. On-going due diligence & compliance training

**Adherence Compliance Enterprise Compliance Platform**

**SCORE App**

*Available in the App Store*

*Over 600 Cannabis Risk Assessments Delivered to Date!*

**State, City & County Rules & Regulations:** Licensing; Licensed Premise; Dispensary/Store; Cultivation Center; Infused Producer; Testing; Business Records Required; Labeling, Packaging & Product Safety; Permits; Fire; Use Licenses; Inventory & Financial; Security & Surveillance; Transport
Application Processing, Screening & Acceptance

Screening a marijuana business for an operating account can be a daunting task. One bank in Colorado has a checklist requiring more than forty (40) documents prior to processing an application for a business account that sells, processes, cultivates, manufactures, distributes or tests marijuana as its primary licensed business.

Along with standard legal agreements, account information and required financial information, banks and credit unions can also require:

- **Ownership and Owner Details** — resumes, operating and licensing agreements, investor lists and associated contract agreements
- **Operational Details** — vendor and payee lists (GL), employee lists, leases, licensing agreements, cash management systems and insurance policies
- **State Documentation** — corporate statements, licenses, state application, articles of organization, certificates or transmittals of good standing and facilities diagrams
- **City and/or County Documentation** — required permits, local regulatory requirements from public safety, fire, licensing and various ordinances
- **Regulatory Compliance Documentation** — standard operating procedures (federal, state and local requirements), training protocols, enforcement and discipline violations and/or citations, proof of compliance or evidence of regulatory inspections or audits
- **Validation or Deposit Documentation** — state-mandated inventory tracking system reports or verification, tax filings, EOM point-of-sale sales summaries along with transactional data

With the amount of detail required, this type of scrutiny during application screening is unprecedented for most businesses and subject to many pitfalls. The marijuana industry continues to be one of the most highly regulated industries in the world.
Account Setup & Reporting

Once a marijuana business has been accepted by the institution and approved for an operating account, banks must file a suspicious activity report (SAR) at account opening. The initiation SAR, termed a “Marijuana Limited” SAR identifies the account and potential risk. Most banks would need to alter current policies related to managing anti-money laundering programs and SARs to address exceptions in their current programs.

Another consideration for institutions banking marijuana is currency transaction reports, or CTRs. FinCEN, the Financial Crimes Enforcement Network requires a CTR to be filed for each deposit, withdrawal or other payment or transfer of more than $10,000. To address this consideration, most banks would need to ensure marijuana businesses are ineligible for currency transaction report exemptions. This would make it a required filing any time a marijuana business exceeds the mandated threshold.

The Cole Memo stipulates that marijuana is still considered a dangerous drug. On the federal level, distribution and sale of marijuana is a serious crime. Top priorities include:

- Preventing the distribution of marijuana to minors;
- 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 drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;

To facilitate reporting requirements, design a marijuana account compliance risk management framework and develop written compliance program documents consistent with the institution’s objectives and regulatory requirements. Focus on scalable, effective, low-cost processes to support readiness reviews, risk and control assessments, remediation and transaction testing. Effective on-boarding and account setup is imperative for institutions to support monitoring and reporting requirements. Preparing for continual regulatory inspections is a first order of priority.

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1James M. Cole, Deputy Attorney General, U.S. Department of Justice, Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement, August 29, 2013
Routine Compliance Monitoring

Routine compliance monitoring involves assessing and evaluating a standard or common set of rules and requirements by operational license location in an automated, repeated fashion. Effective compliance monitoring includes establishing a baseline or scoring mechanism to track and report on overall progress. The leading marijuana compliance software in the market, the Adherence SCORE App, lists more than 330 operational requirements (federal, state, city and county) in its compliance assessment for a retail (21+) CO2 Manufacturer license located in Denver Colorado.

A CO2 Manufacturer is a licensed provider of concentrates, ingestible or topical marijuana derivatives. The average compliance score for the retail marijuana infused producer license type in Colorado is 81.6% in 2017, based on more than 25 inspections conducted on this specific license type. On average these license types fail more than 16 federal, state and/or local compliance requirements. According to Adherence’s proprietary marijuana compliance scoring algorithm, an inspection score in the low 80s is classified as low-to-medium closure risk:

**Adherence Risk Score Classification**

- 91-100%  Strong Compliance
- 81-90%  Low-to-Medium Closure Risk
- 71-80%  Medium-to-High Closure Risk
- 61-70%  Immediate Closure Risk

Monitoring overall regulatory compliance categories at the license premise or location is just as imperative as monitoring financial and transactional aspects of the business. Automation of compliance is a key value driver of any routine monitoring program.
Secure Cash Management & Deposit Verification

Currently, the top credit card vendors in the U.S. will not allow PIN-debit or credit card transactions by a merchant that is identified as a legal marijuana business. For institutions considering setting up a program, account holders must process cash for all marijuana product sales. The handling of currency creates the need for a secure cash management supply chain, including money processing, transport and verification reporting.

Identification and correction of cash management issues should be a top priority for all stakeholders involved. Effective cash management starts with a well-documented plans (e.g. Standard Operating Procedures covering federal, state, city and county requirements) and aligning with a secure, insured vendor for processing solutions, deposits and cash vaulting needs.

Common areas of secure cash management consideration are:

- Cash collection, receipt & deposit policies
- Depositing, verification and reporting
- Cash A/P and A/R processing
- Segregation of duties for cash control

Until credit card processors legally support marijuana businesses, reducing the risks associated with cash handling should be a key objective of any marijuana banking program.
On-going Due Diligence & Compliance Training

As banks are unable to absolve their operational risk with marijuana businesses, staying ahead of the compliance curve will be instrumental in managing an effective marijuana banking program. Enhanced due diligence will be of utmost importance.

On-Going Due Diligence

A marijuana banking program can be expected to be routinely reviewed by and commented on by regulatory authorities. On-going due diligence requires continual program evaluation internally to ensure teams are ready for regulators. Once regulators arrive, institutions should plan to educate stakeholders in advance of program review to ensure a common understanding of the industry and requirements is achieved.

Continuing Education

Given the four (4) levels of regulatory oversight (federal, state, city and county), continuing education and compliance training is critical to program success. As this is an emerging and growing market, compliance will continue to be a core competency for successful marijuana businesses and banking programs. With new and ever changing regulations, continual review of regulatory rules and requirements will be necessary to ensure account holders are compliant across multiple categories.

To reduce the systemic risk of banking marijuana businesses and establishing scalable programs, on-going due diligence and continuing education needs to take place not only within the institution but with the operating account holders as well.
Marijuana Banking Software?

Do banks need to buy expensive in-house marijuana monitoring software that requires costly implementation and licensing fees? It may be better to spend that time and effort on ensuring the up-front vetting or a proper account verification process is in place, as well as understanding of how the business processes and accounts for inventory. Many marijuana businesses are faced with reconciling multiple, disparate inventory systems. e.g.:

- Physical or on-hand inventory
- Point-of-Sale inventory
- State-mandated inventory tracking system
- Accounting system (e.g. Quickbooks)

Does “out-of-the-box” marijuana banking software ensure that up to four (4) disparate systems are accurately reconciled? Does the software ensure that Starting Inventory is compliant, that no diversion or theft has previously occurred and that state-based inventory tracking system reconciliation is occurring on a daily basis? A physical inventory inspection along with comparative analysis of inventory system reconciliation should occur first. Has this particular marijuana business always been compliant with inventory? If inventory has been incorrect in the past, all revenue and taxes reported and filed during that time period may be incorrect as well.

Garbage In, Garbage Out

Does the marijuana business employ a revenue and tax accountant? How does it monitor and manage marijuana product vendor accounts? Is the business properly coding expenses as per IRS 280e requirements and is it appropriately processing tax payments? Without a solid foundation, the overall liability of previous inventory tracking (and omissions) may be too great of a risk for a financial institution absorb. Current cannabis banking solutions usually lack any type of inventory adjustment and reconciliation process.

Some banks are betting “out-of-the-box” marijuana banking software can help, however many are learning expensive lessons in managing and maintaining yet another monitoring system. Most banks already have suitable AML/BSA systems in place for monitoring and alarming on various limits or thresholds on active account holders. The process, not costly software, should be the focus for establishing a successful marijuana banking compliance program.
Hope for the Immediate Future?

With California's upcoming retail and medical legalization effort in full force in 2018, it’s only a matter of time until CA State Assemblies start proactively addressing the banking and all-cash situation with marijuana. Until the federal government acts, hopes for continued marijuana banking will remain at the local or state level. Current states banking marijuana accounts include Colorado, Washington, Maryland, Illinois, New Jersey, Massachusetts, Arizona, Hawaii, Pennsylvania and more. New states coming online are Florida, Ohio, Michigan, New York, Minnesota and others. With billions in cash on the streets, more banking solutions are needed.

Adherence to compliance requirements will be key. Standardization or a common framework of marijuana rules and requirements at any level remains highly unlikely. Institutions will need to consider the evolving market when reviewing and implementing a compliant banking program.

For more information on cannabis banking compliance and program proposals, please contact Adherence for next steps.

For more information on cannabis compliance inspections, software & related programs, operations & compliance training, regulatory search along with data and statistics, please contact Adherence Compliance at:

720-616-3900 or visit www.adherence-corp.com/contact.html. Request a demo today.

As seen in:

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About the Author

Steve Owens, International MBA, is the CEO and Founder of Adherence Compliance and is considered a thought leader in regulatory and financial cannabis compliance. He has written extensively in the areas of operational compliance and has more than four (4) years of cannabis regulatory and financial compliance expertise.

About Adherence Compliance

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- Compliance Software & Programs
- Operational & Business Templates
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