
New Guidance on Financial Services and Marijuana-Related Businesses

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The Obama Administration took steps last week to potentially pave the way for marijuana growers and related businesses to obtain core financial services. As more states have moved to legalize marijuana sales under certain circumstances, many financial institutions have been reluctant to provide attendant banking services, out of fear of prosecution, regulatory action at the federal or state level, or significant reputational risks arising from congressional or other scrutiny, particularly of first-mover financial institutions. As a result, the majority of legal marijuana-related transactions still take place in cash, outside the formal financial system. Observers have noted that the vast amount of cash in this sector has created increasing security risks, driven financial conduct underground, and made it more difficult for law enforcement to “follow the money.”

In response to these concerns, the Justice Department and the Treasury Department’s Financial Crimes Enforcement Network (FinCEN), the administrator of anti-money laundering (AML) provisions of the Bank Secrecy Act (BSA), issued concurrent guidance on February 14, 2014 to prosecutors and financial institutions, respectively. (The February 2014 DOJ Memorandum is available [here](#), and the FinCEN guidance is available [here](#).) The documents are intended to (1) clarify that providing financial services to marijuana businesses that do not run afoul of the Justice Department’s priorities and whose activities are legal under state laws is not a priority, given DOJ’s limited prosecutorial resources; and (2) create a framework under which financial institutions can provide services to legalized marijuana businesses within current BSA requirements. Although the guidance conveys the Administration’s policy and priorities, it does not carry the force of law, and thus does not fully resolve risks of prosecution, regulatory exposure and reputational harm—a point emphasized by a leading Member of Congress as well as several trade associations.

Set forth below are key provisions of the guidance, as well as some observations regarding the broader contexts and opposing views at work in this debate. We continue to believe that this market presents substantial risks and that financial institutions should continue to press for more certain exposure-reducing measures. Further, even those financial institutions that do not intend to provide services to marijuana businesses may want to review current and new customer relationships for inadvertent exposure to the sector.

The Justice Department's Memoranda

Deputy Attorney General James Cole issued the February 14, 2014 Memorandum to US Attorneys as a follow-up to his August 29, 2013 [Memorandum](#) setting forth the Department's eight enforcement priorities with respect to marijuana. These include, but are not limited to, preventing the distribution of marijuana to minors, preventing revenue from marijuana sales from going to criminal organizations, and preventing state-licensed activity from being used as a cover for illegal activity.

The February 2014 Memorandum focuses on financial crimes associated with marijuana sales, and sets forth guidance on prosecutors' use of their discretion and resources. It states that financial institutions that intentionally provide services that implicate the eight priorities listed in the August 2013 Memorandum might be appropriate for prosecution. Notably, the February 2014 Memorandum further warns that financial institutions that are wilfully blind to such activity may also face prosecution. Failure to conduct appropriate due diligence of customers' activities is an example of such wilful blindness. In contrast, the February 2014 Memorandum states, "if a financial institution or individual offers services to a marijuana-related business whose activities do not implicate any of the eight priority factors, prosecution for these offenses *may not be appropriate*." (Emphasis added.)

FinCEN Guidance

According to FinCEN, its February 14, 2014 guidance "should enhance the availability of financial services for, and the transparency of, marijuana-related businesses." The document lays out several measures that financial institutions should take with respect to such businesses, in order to meet their BSA obligations.

First, it sets forth seven due diligence steps that financial institutions should take with regard to marijuana businesses:

1. Verifying with the appropriate state authorities whether the business is duly licensed and registered;
2. Reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business;
3. Requesting from state licensing and enforcement authorities available information about the business and related parties;
4. 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);
5. Ongoing monitoring of publicly available sources for adverse information about the business and related parties;
6. Ongoing monitoring for suspicious activity, including for any of the red flags described in

this guidance; and

7. Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.

Implicit in these due diligence measures is a requirement that financial institutions have a thorough and current understanding of marijuana licensing and other regulations across the states where some form of marijuana sales has been legalized. (As of February 14, 2014, some 20 states and the District of Columbia had authorized some type of marijuana sales.) Thus, in order to implement these due diligence measures, financial institution compliance and legal teams need to remain abreast of a myriad of developments at the state level.

With this guidance, FinCEN also has created entirely new classes of Suspicious Activity Reports (SARs) related exclusively to the marijuana industry:

- **“*Marijuana Limited*” SARs:** Financial institutions are required to file this category of SARs when they reasonably believe the marijuana-related transactions *do not run afoul* of DOJ’s priorities *and are permitted* under state laws. This new category of SARs was created in recognition of the fact that marijuana sales continue to be illegal at the federal level. While not expressly stated in the guidance, this SAR category may provide financial institutions some “cover” with their regulators (discussed further below). Once the initial filing is made, the financial institution will need to take care to meet its continuing SAR filing obligations for the life of the relationship. (See FinCEN Frequently Asked Question #16 on continuing SAR obligations, available [here](#).)
- **“*Marijuana Priority*” SARs:** Conversely, financial institutions are required to file this type of SAR when they reasonably believe that marijuana-related transactions *do implicate* DOJ’s priorities *and/or violate state law*. This new category is more akin to the current requirement to detect and report suspicious activity.
- **“*Marijuana Termination*” SARs:** Financial institutions should use this type of SAR when their risk-based procedures mandate closure of a marijuana-related account. We note that the underlying activity could be legal or illegal, as accounts may be terminated for a variety of reasons.

Financial institutions are mandated by the guidance to include the classification in the narrative section of the SAR filing, to enable law enforcement and regulators to sort and prioritize their reviews of SARs.

FinCEN’s guidance also contains more than 20 “red flags” that may indicate that a marijuana-related customer may be engaging in business that runs afoul of DOJ’s priorities, and/or state law. Several of these red flags involve deviations from a customer’s or a peer’s expected activity. Financial institutions may struggle to establish such baselines as they embark on these customer relationships. In addition, FinCEN strongly encourages the use of voluntary information-sharing among financial institutions under Section 314(b) of the PATRIOT Act, in order to promote compliance with the guidance and to strengthen the financial system more broadly.

The Hill Speaks Out

Congressional leaders have spoken out on both sides of the issue. A bipartisan group of 18 Members of Congress sent a [letter](#) to President Obama on February 12, 2014 to request that he re-classify marijuana as a lesser narcotic, which would lessen the impact of violations of relevant laws at the federal level, and would have tax benefits for legalized marijuana businesses.

On the other hand, Senator Chuck Grassley (R-IA), ranking minority member of the Judiciary Committee, registered his disagreement with the Administration's approach to these issues. "The Administration can't change the law with a memo," Grassley said on his [website](#) on the same day that DOJ and FinCEN issued the guidance. Senator Grassley has a history of launching congressional investigations that garner significant media attention and support from Republicans in the House of Representatives, where Republicans are in the majority, and we expect that he may follow that path here, focusing on federal agencies and first-movers among financial institutions. We also anticipate that some State Attorneys General will side with Senator Grassley, and could launch similar inquiries.

Whither the Other Regulators?

Noticeably absent from the FinCEN advisory were the federal functional regulators, including the Federal Reserve, OCC, FDIC and SEC and others. These regulators examine for and have independent enforcement authority over AML compliance at financial institutions—authorities that they have exercised at unprecedented levels in recent years. As a result, financial institutions may benefit from a dialogue with their supervisors when considering providing services to marijuana-related businesses.

Industry Concerns Remain

Because the guidance is careful to state that it does not constitute a defense to criminal or regulatory action, some in the private sector have taken the DOJ and Treasury guidance as cold comfort. The financial services sector remains concerned about prosecution, regulatory action and reputational harm from dealing with marijuana-related businesses whose activities are still illegal at the federal level. The Colorado Bankers Association voiced its dissatisfaction with the guidance, and continues to press for legislative changes at the federal level that would provide more solid relief.

The guidance also could be reversed with more ease than a regulatory or statutory change, potentially leaving institutions with exposure for actions taken in reliance on current guidance. In the event of such a reversal, transactions that violate drug trafficking laws or SAR requirements may have taken place within the relevant statutes of limitation.

Finally, even those financial institutions that do not intend to provide services to marijuana-related businesses may want to assess whether they have existing, undisclosed relationships with the

marijuana industry, and whether their due diligence and transaction monitoring controls are adequate to identify new ones. Given the new construct for filing SARs, financial institutions should consider whether their policies and procedures for reporting of suspicious activity and termination of accounts follow the new standards.

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