

PERSPECTIVE



CHANGES EVERYTHING.

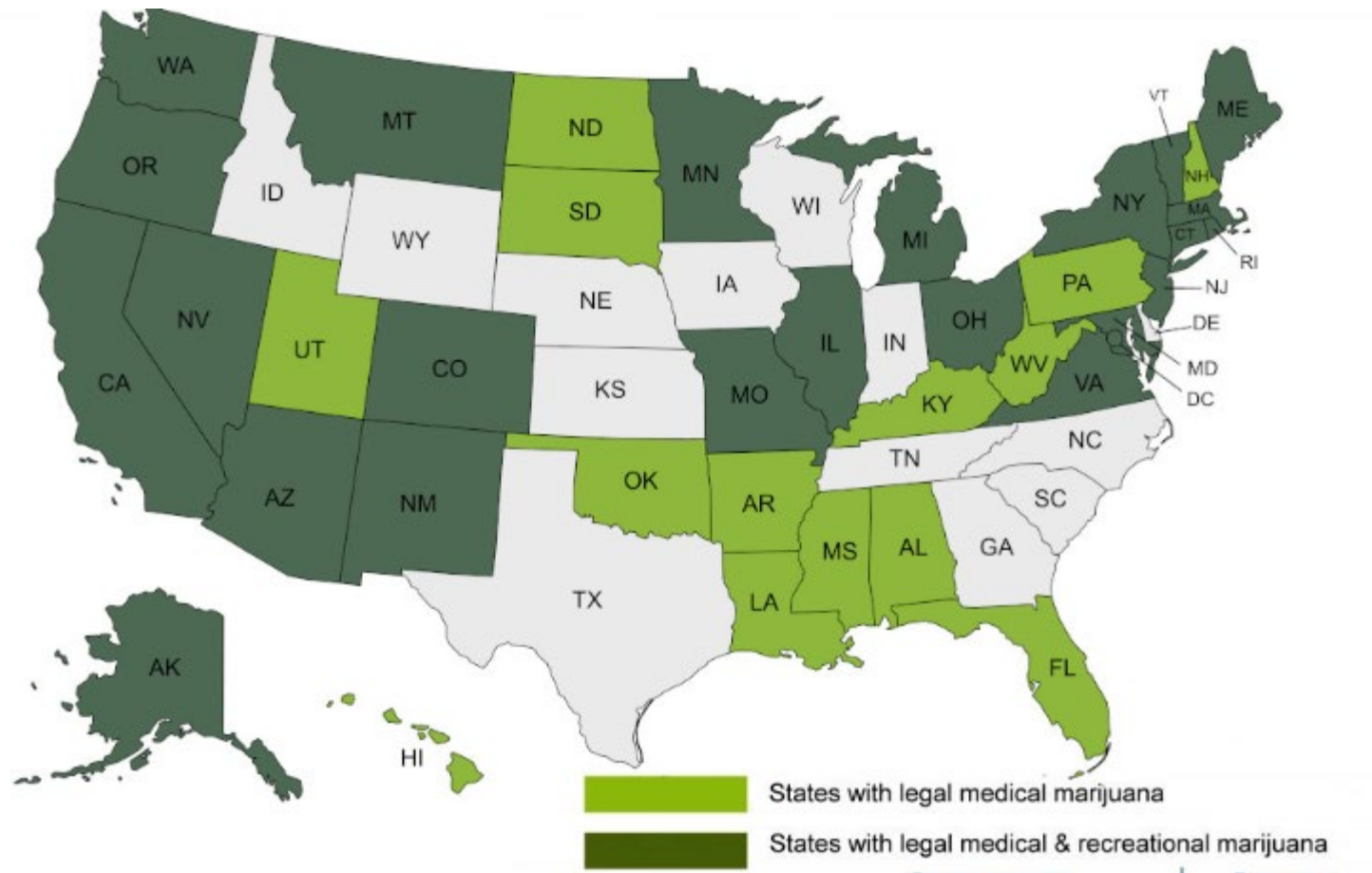
Managing Cannabis Risk

Robin Guthridge, Director, CAMS, CRCM

WIPFLI

Navigating the regulatory landscape

Marijuana across the U.S. (as of Sept 2024)



Question

- Which of the following drug is not covered under the 1970 Controlled Substances Act?
 - A. Heroin
 - B. Marijuana
 - C. Bath salts
 - D. Alcohol

Answer

- Alcohol, while addictive, is not considered a controlled substance. Bath salts; however, have very similar components as ecstasy.

Path to legalization

- Richard Nixon, during his 1968 presidential campaign, promised to restore “law and order” to America. Upon being elected, he declared a war against drug abuse.
- Under Nixon’s presidency, the federal government passed the 1970 Controlled Substances Act, which classified drugs on four different schedules. The federal act classified cannabis as a Schedule I drug, causing it to be considered one of the most dangerous substances that carry the highest penalty.
 - The law consists of four “Schedules” which are ranked based on highest risk for potential abuse.

Path to legalization

- Schedule I: Drugs in this category have no currently accepted medical use and a high potential for abuse (heroin, LSD, peyote, marijuana).
- Schedule II: These drugs have a high potential for abuse, and their use can lead to severe psychological or physical dependence (cocaine, fentanyl, methamphetamine)
- Schedule III: Drugs in this category have a moderate to low potential for physical and psychological dependence (Tylenol with codeine, testosterone, ketamine).
- Schedule IV: These drugs have a low potential for abuse and a low risk of dependence (Xanax, Valium, Tramadol).

Path to legalization

- The Congressional Cannabis Caucus have proposed several initiatives:
 - Marijuana Opportunity Reinvestment and Expungement (MORE) Act seeks to remove cannabis from the Controlled Substance Act and purge records for those convicted of using marijuana.
 - On October 6, 2022, President Biden issued a presidential pardon
 - Pardoned federal convictions for simple marijuana possession offenses, which applied only to federal convictions, and did not apply to any other offense of which the individual may also have been convicted
 - Secure and Fair Enforcement (SAFE) Banking Act of 2019 or SAFE Banking Act, that would protect banks and their employees from punishment for providing services to cannabis businesses that are legal on a state level.

Marijuana “rescheduling”

- On May 16, 2024, the Justice Department submitted a proposed regulation to initiate formal rulemaking to move marijuana from a Schedule I to Schedule III drug.
 - This change would acknowledge marijuana’s accepted medical use in the U.S.
- The process involved a 60-day comment period (which ended July 22, 2024). The DEA will gather comments and information before making a final determination.

SAFE Banking Act – HR 1595

- A Federal banking regulator may not prohibit the following solely because the depository institution provides or has provided financial services to a cannabis-related legitimate business or service provider.
 - Limit the deposit insurance of a depository institution.
 - Prohibit, penalize, or otherwise discourage a depository institution from providing financial services to a cannabis-related legitimate business or service.
 - Recommend, incentivize, or encourage a depository institution to not to offer financial services to an account holder, or to downgrade or cancel the financial services offered to an account holder.
 - May not take any adverse or corrective supervisory action on a loan made to a cannabis-related legitimate business or service provider.
 - May not take any adverse action towards an owner or operator of real estate or equipment that is leased to a cannabis-related legitimate business or service provider.

SAFE Banking Act – HR 1595

- May not prohibit or penalize a third-party depository institution, or entity performing services for the depository institution, such as authorizing, processing, clearing, settling, billing, transferring, reconciling, or collecting payments for a cannabis-related legitimate business, (by any means, including a credit, debit, check, or electronic funds transfer.
- The proceeds from a transaction conducted by a cannabis-related legitimate business or service provider shall not be considered as proceeds from an unlawful activity solely because the transaction was conducted by a cannabis-related legitimate business or service provider, as applicable.
- Directors, and employees of that depository institution may not be held liable pursuant to any Federal law or regulation solely for providing such financial services; or for further investing any income derived from such financial services.

SAFE Banking Act – HR 1595

- A depository institution that has a legal interest in the collateral for a loan of a cannabis-related legitimate business or service provider, or to an owner or operator of real estate or equipment that is leased or sold to a cannabis-related legitimate business or service provider, shall not be subject to criminal, civil, or administrative forfeiture for providing such loan.
- In 2023, the SAFE Banking Act was renamed the Secure and Fair Enforcement Regulation (SAFER) Banking Act.
 - It was passed multiple times by the House but keeps stalling in the Senate.

Federal regulatory guidance

- FinCEN provided guidance in FIN 2014-G001, which clarifies BSA expectations for banks seeking to provide services to marijuana-related businesses. The guidance sets forth “priorities” under the “Cole Memo,” which the Department of Justice stated it would utilize to prosecute only those which pose a significant threat with regard to the manufacturing and sale of marijuana. (The Cole Memo was rescinded by the Attorney General in January 2018; however, FinCEN’s guidance (FIN 2014-G001) remains in effect and the Cole Memo is widely considered a reliable resource by industry experts).
- While not explicitly stated by the current Attorney General, it appears the Department of Justice will continue to uphold the spirit of the Cole Memo and not bring action against those who remain compliant with state laws.

Knowing the difference

Hemp, CBD, Delta variants, marijuana, etc.

Marijuana

- Classified as a Schedule 1 drug under the Controlled Substances Act of 1970, causing it to be considered one of the most dangerous substances and carrying the highest potential penalties
- THC is the compound that provides the “high” feeling; therefore, any part of the plant that contains a THC concentration of more than 0.3 percent is considered marijuana
- In all states where marijuana is legal, businesses must have a license from the state to sell
 - There is no limit to what percentage of THC is legal when shopping in a recreational dispensary
 - There are limits to how much you can purchase based on state law
 - When shopping for hemp products that are sold outside of dispensary channels, the legal limit for THC is 0.3%

Hemp and CBD

- Any part of the plant that contains a THC concentration of less than 0.3 percent is defined as hemp
- The lower THC concentration makes it impossible to feel any psychoactive effect
- While a wide range of products, from fibers to grain, seed, food, and beverages, the most popular product is cannabidiol (CBD)
- The industry is still regulated, with CBD subject to FDA oversight with respect to advertisements.

True or False?

- Delta variants of CBD are federally legal since they are not classified as marijuana.

Answer

- **FALSE**. As of February 2023, the U.S. Drug Enforcement Administration stated both cannabinoids delta-8 and delta-9 THC-O, are to be considered illegal controlled substances on the federal level, due to their chemical structures and pharmacological activities, which are similar to the delta-9 THC psychoactive compound of marijuana.

Delta variants

- Hemp-derived cousins of cannabis
 - Process does not occur naturally but is obtained synthetically and therefore do not fall under the definition of hemp.

Delta -8 THC

- Typically manufactured in concentrated amounts from hemp-derived CBD
- CBD doesn't have any intoxicating effects; however, delta-8 THC has similar psychoactive properties to delta-9 THC, though typically less potent
- Delta-8 is available in many forms: gummies, chocolate, candy, cookies, tinctures, vaping cartridges, infused drinks, breakfast cereal, etc.
- THC level low and most likely not detected on a drug test
- Illegal at the federal level and also illegal in several states

Delta -9 THC

- Naturally occurring intoxicant component of the cannabis plant
- When someone smokes or consumes Delta-9, they typically experience a “high”
- In a state where delta-9 is legal, it is sold in a cannabis dispensary
- Delta-9 available in many forms: gummies, cookies, candies, infused beverages, tinctures, vaping cartridges, topical lotions, and pre-rolled “joints”
- Detected on a drug test
- Illegal at the federal level but legal recreationally and/or for medical use in several states

Delta -10 THC

- Produced in a similar way as delta-8 (synthetic)
- Produced from plants containing less than 0.3% delta-9 THC
- Psychoactive effect less potent than both delta-8 and delta-9
- Unclear if a positive drug test result could be produced
- Delta-10 available in several forms: oil cartridges, disposable vapes, raw distillate, edibles (gummies, capsules, etc.)
- Illegal at the federal level and also illegal in several states

THC-O

- Hemp derived, synthetic cannabinoid
- CBD is extracted from the hemp plant and converted to delta-8, then converted to THC-O
- Produces mild hallucinogenic or psychedelic effects
- May be three times more potent than delta-9
- Available in several forms: edibles, vapes
- Illegal at the federal level but legal in *most* states

True or False?

- CBD oils, vapes and tinctures are federally legal since they are not classified as marijuana.

Answer

- **FALSE.** The sale and use of CBD products is illegal in Idaho, Wyoming, Kansas, North Carolina, and Nebraska

Tier 1 MRB

State -licensed businesses involved in the manufacturing, distribution, and dispensing of marijuana

Tier 2 MRB

Focused on providing products and services to Tier I MRBs and the industry

Tier 3 MRB

Not specifically focused on selling products or services to Tier I MRBs and the industry, but may receive some income

Marijuana banking tiers

- Consist of state-licensed businesses that are involved in the manufacturing, distribution, and dispensing of marijuana
 - Retail locations, growing operations, and manufacturing of edibles
 - Cannabis seed sellers, cannabis processing companies, and cannabis testing companies because they directly handle the product
 - May also include, to an extent, persons or businesses who have a financial or controlling interest in the MRB

Tier I MRB

Marijuana banking tiers

- Focused on providing products and services to Tier I MRBs and the marijuana industry; most of the Tier II income may be derived directly from Tier I MRBs
 - They may also include suppliers, security firms, armored car couriers, licensing and consulting companies, vendors, and employees of MRBs

Tier II MRB

Marijuana banking tiers

- Not specifically focused on selling their products or services to Tier I MRBs and the marijuana industry; most of the Tier III income may be derived from providing services to businesses other than Tier I MRBs
 - They may also include utility companies, municipalities, attorneys, restaurants, accounting firms, law firms, or other cannabis-related businesses, such as hemp testing companies

Tier III MRB



Marijuana banking program considerations

MRB considerations

- For those that decide to engage with MRBs, there are legal, operational, reputational, and compliance risks to consider
- Proper identification of the risk level of each MRB account is important because regulatory action may result in the institution shutting down its marijuana program, may require a remediation of cannabis transactions for a certain period from its clients, or may result in other legal or regulatory ramifications
- A risk-based approach includes:
 - Setting up a program with strong internal controls
 - Comprehensive CIP/CDD/EDD at onboarding
 - Continued monitoring throughout the relationship
 - Compliance with required filing and SAR reporting requirements

MRB considerations – setting up a program with strong internal controls

- Collaborate with the board of directors, senior management, and others
- Consider your customer base and their tolerance with doing business with a financial institution that receives income from a designated federally illegal operation
- Conduct a legal review of applicable federal and state laws, including potential seizure of property and forfeiture from federal agencies
- Perform a review of applicable FinCEN and interagency guidance related to the monitoring and reporting requirements of MRBs
- Obtain legal advice from counsel experienced with the risks related to banking MRBs
- Inform your respective state and federal regulatory examiner and independent auditor of the intention to bank MRBs

MRB considerations – setting up a program with strong internal controls

- Ensure the BSA Officer has appropriate qualifications, training, and certification specific to the risk profile of MRBs
- Conduct a staffing analysis to determine staffing resources needed to conduct ongoing due diligence, monitoring, and to comply with federal reporting requirements
- Determine if a list of limitations will be placed on the products and/or services that will not be available to the MRB
- Also, determine how your institution will identify new or existing customers who are employees or vendors of MRBs whose primary income is derived from Tier I MRB relationships

MRB considerations – setting up a program with strong internal controls

- Develop comprehensive policies and procedures that address all Tier level MRB businesses and all varietal of hemp businesses
 - Outline risk-rating criteria
 - Confirm CDD/EDD procedures are thoroughly documented, including transactional and product monitoring procedures
 - Develop onboarding questionnaires
 - Include an account closing policy
- Assess how daily cash deposits will be handled
 - If conducted within the branch network, determine if security is sufficient to protect employees

MRB considerations – setting up a program with strong internal controls

- Establish appropriate risk based pricing standards for MRB deposit accounts to cover the cost of monitoring and oversight of the MRB, such as:
 - Flat fee per account – which would allow fees to be assigned based on use of account; a payroll account may have more ACH transactions and require less staff interaction than a cash intensive account, where cash must be processed and monitored
 - Flat fee per customer relationship – allows the bank to assign a risk-based fee based on the type of MRB it is banking; a customer relationship that is only an investor is inherently lower risk and may require less detailed monitoring than a MRB dispensary
 - Scaled fee based on products and services utilized – this may be the fairest way to pass the cost of compliance on to the MRB in that both accounts and nature of customer relationships are considered

MRB considerations – onboarding

- Each MRB relationship should have its own risk assessment at the time of account opening, and updated, as applicable
- Beneficial ownership information should be drilled down below 25%
- Review the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business
- Develop an understanding of the normal and expected activity for the business, including the types of products to be sold and the types of customers to be served
- Complete an onboarding questionnaire
- Conduct a robust negative news search on all owners of the MRB

MRB considerations – continued monitoring throughout the relationship

- For MRB funds derived from sales at retail locations, ensure funds deposited are commensurate with the nature/type of facility
 - Appropriate systems should be in place to ensure no money from illegal sales is commingled with legal sales
 - If banking MRB with retail locations, custom “seed to sale” software should be considered
- If the MRB has a multi-state presence, perform a review to facilitate tracking the source of all incoming and outgoing funds for suspicious activity

MRB considerations – continued monitoring throughout the relationship

- Conduct ongoing monitoring of publicly available sources for adverse information about the business and related parties
- Perform CDD/EDD reviews in accordance with the timeframe and review structure outlined in policy
 - Incorporate Cole Memo directives into the review structure
- Conduct ongoing monitoring for suspicious activity, including for any of the red flags described in regulatory guidance
- Perform on-site visits
- Determine whether licensing remains updated

MRB considerations – compliance with required filing and SAR reporting requirements

- File SARs in accordance with FinCEN Guidance
 - Marijuana Limited SAR
 - Marijuana Priority SAR
 - Marijuana Termination SAR

True or False?

- A SAR must be filed if the financial institution has an account with a Tier II or Tier III marijuana business or person.

Answer

- **FALSE.** FinCEN guidance only addresses SAR filings for Tier I MRBs. The expectation is to not flood the SAR database with SARs that offer little value to law enforcement; therefore, a SAR would only be required if suspicious or unusual activity is presented through the account that is not commensurate with the occupation or nature of business.



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