

ROADMAP TO AN EFFECTIVE CANNABIS COMPLIANCE PROGRAM: CALIFORNIA DBO BANKING GUIDANCE

Western Bankers Association – 2020 Cannabis Forum

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Speakers



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- Regulatory Background

- DBO Guidance
 - Program Governance
 - File Review
 - Account Testing/Identification of FinCEN Red Flags
 - Cole Memo Priorities
 - FinCEN Filings

- Conclusion

Introduction

- As states decriminalize recreational cannabis and national legislation languishes, financial institutions find themselves in limbo with conflicting Federal and state standards
- FinCEN's guidance is light on specifics and national banking regulators remain silent
- Recent guidance from the California Department of Business Oversight provides a useful roadmap to develop cannabis banking program and controls

REGULATORY BACKGROUND

Regulatory Background

Proposition 64 – The Control, Regulate and Tax Adult Use of Marijuana Act (Prop 64)

- Permits adults 21 years of age and over to possess and grow specified amounts of marijuana for recreational use
- Passed in November 2016 and went into effect immediately



Regulatory Background

U.S. Department of Justice Cole Memo

- Issued August 2013 to guide investigative and prosecutorial discretion
- Identified eight marijuana-related enforcement priorities
- Leaves enforcement outside of the listed priorities to state and local authorities, provided there is a strong regulatory and enforcement regime in place
- Rescinded in January 2018



Regulatory Background

FinCEN Guidance

- Issued in February 2014
- Addresses the eight Cole Memo priorities
- Outlines customer due diligence expectations and red flags
- Imposes unique marijuana SAR requirements
- Prohibits CTR exempt designation for MRBs.



Regulatory Background

DBO Cannabis Guidance Memo

- Issued in October 2019 in form of a questionnaire
- Addresses Cole Memo priorities and FinCEN guidance
- Provides more operational detail than prior guidance
- Builds on August 2019 Conference of State Bank Supervisors (“CSBS”) Cannabis Job Aid



DBO GUIDANCE

Guidance Issuance

- Issued October 3, 2019
- Applies to state-chartered institutions
- Guidance for those offering products and services to MRBs and those that are developing pilot programs
- Jurisdiction is of state-chartered banks, credit unions, money transmitters, securities broker-dealers, investment advisors, non-bank installment lenders, payday lenders, mortgage lenders and servicers, escrow companies, etc.

Guidance Issuance (cont.)

- DBO will not bring regulatory actions against institutions offering services to MRBs
- DBO expectations of institutions offering products and services to CRBs
 - Institutions are to follow FinCEN's BSA expectations, including the guidance FinCEN provided in 2014 and priorities set forth in the Cole Memo
 - Institutions are to appropriately identify, assess, and manage risks appropriately

Section I – Program Governance

Developing Policies and Procedures

- Risk assessment
 - Legal review (forfeiture and seizure)
 - Confirmation with third party service providers
 - Contingency plan to exit relationships
- Adequate, board approved policies and procedures
 - Definition of MRB
 - Limitations to the program
 - Site inspections
 - Handling of accounts not in-line with policy
 - Training
 - Enterprise Risk Management inclusion

Section I – Program Governance

Program Considerations

- Cash management practices
- BSA Officer authority
- Prohibition of CTR exemption
- SAR filing requirements

- BSA monitoring software upgrade or adjustments
 - Independent review of parameters
- Manual or automated suspicious activity monitoring
 - MRB inclusion as high-risk accounts
 - Machine learning, AI, or cloud-based monitoring
- Appropriate risk-based pricing standards
 - Limitations on what products and services will be available
 - Restrictions on transactions
 - Segregation of funds from other deposits

Section I – Program Governance

Program Considerations

- Appropriate training
 - Board
 - Senior management
 - Employees
- Adequate staffing and resources
- ALLL methodology
- Independent loan review to the policy:
 - Acceleration of loan terms and call balance due
 - Loss of license
 - Violates Cole Memo objectives
 - Red flags
 - Procedures for preventing ongoing Cole Memo violations
 - Lending to indirectly related parties (e.g. landlords)
 - Searches for unknown MRBs

Section II - File Review

The File Review focuses on due diligence processes for MRB customers.

- Steps mirror due diligence expectations in FinCEN guidance with California-specific details
- Financial Institutions will need to tailor to their state-specific requirements

Section II - File Review

Keys to effective Customer Due Diligence (“CDD”)

- Confirm and document all state licensing requirements
- Due diligence on parties of interest – beneficial owners, partners, vendors, etc.
- Verify access requirements are met (site visit)
- Expected activity, products sold, customers
- Initial and ongoing monitoring of external sources for negative information
- Due diligence is focused on Cole Memo priorities and FinCEN Guidance red flags
- Periodic refresh of CDD information – DBO suggests **at least every 90 days**

Section III - Account Testing/Identification of FinCEN Red Flags

The Account Testing/Identification of FinCEN Red Flags focuses on suspicious activity monitoring processes for MRB customers.

- Copy of many of the FinCEN Red Flags
- DBO also includes specific red flags related to retail outlets:
 - Only sells marijuana, marijuana infused products and marijuana paraphernalia?
 - Only sells marijuana advertised for medical purposes if the retailer has a “medical marijuana endorsement?”

Section III - Account Testing/Identification of FinCEN Red Flags

Keys to effective Suspicious Activity Monitoring

- Understand expected transaction volumes based on financial statements and revenue reports
- Be aware of transaction volumes and revenue significantly higher than peers/competitors
- Monitor for third party deposits and unknown investors
- Watch for excessive commingling of business/personal funds and employee compensation
- Be alert for rapid movement of funds

Section III - Account Testing/Identification of FinCEN Red Flags

Financial Institutions can implement a variety of suspicious activity monitoring approaches:

- Incorporate scenarios into existing transaction monitoring systems
 - Peer Groups
 - Dedicated alerts
- Implement MRB-specific transaction monitoring systems
- Manual Reviews

Section IV – Cole Memo Priorities

DBO guidance calls for monitoring of Cole Memo Priorities

- This may partially be covered by review of CLA information
- Priorities and related controls should be specifically addressed in MRB risk assessment and the written BSA program

Section V – FinCEN Filings

DBO guidance repeats FinCEN guidance on Marijuana SARs

- Marijuana Limited
- Marijuana Priority
- Marijuana Termination

CONCLUSION

Takeaways

- Make sure Board and Senior Management understand compliance requirements and resource obligations
- Define MRBs and types of acceptable and unacceptable MRBs for your institution
- Tailor program to applicable state-specific requirements
- Specifically address Cole Memo priorities in written program and link to applicable internal controls
- Consider staffing needs in light of CDD/EDD, Monitoring, and regulatory reporting (ongoing SAR filing) burdens
- Where can automation or outsourcing be effective?

THANK YOU FOR
YOUR TIME AND
ATTENTION

QUESTIONS AND ANSWERS

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