

The High Points: SARs and the Three Tiered Framework for MRBs

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As green states continue to grow, intentional or unintentional exposure to Marijuana Related Business (“MRB”) customers for financial institutions and broker-dealers is an inevitability. Whether your business has decided to actively shoulder the risk of allowing MRB customers in pursuit of the large financial reward potential or you’ve decided the risk is not something you are willing to entertain, failure to properly create compliance tools to manage regulatory duties surrounding MRBs is no longer an option.

While more than 30 states and the District of Columbia have legalized medical marijuana, federally only some forms of cannabis has been legalized. Importantly, marijuana itself remains itself a Schedule 1 drug under the Controlled Substances Act leaving banks and broker-dealers with no federal legislation providing clarity. For those financial institutions that make the risk-based decision to engage with cannabis-related businesses—whether involving hemp, marijuana, or as a service provider to such businesses—there are number of risks and opportunities to consider.

As determining risk appetite is an individual company decision, this post will focus on necessary suspicious activity report (“SAR”) filings and the Three Tiers your potential client may fall into. It’s also important to note again, whether or not you make the determination to actively accept MRB customers, your exposure to the industry is becoming a “when” and not “if” discussion and many of your current customers may already be interacting with MRBs without your knowledge. Regulators, as we all know, do not accept ignorance as a defense when exposure is probable and obvious in the business climate.

The Three SARs Related to MRBs

With respect to financial transactions that involve MRBs, FinCEN has outlined three specific kinds of SAR filings expected from financial institutions based on the transactions and activity involved: Marijuana Limited SARs, Marijuana Priority SARs, and Marijuana Termination SARs.

A Marijuana Limited SAR should be filed by a financial institution at the initiation of an MRB customer relationship, and when the financial institution provides financial services to an MRB that the financial institution “reasonably believes, based on its customer due diligence, does not implicate one of the Cole Memo priorities or violate state law.” The Marijuana Limited SAR no longer needs to be filed with every transaction but should include certain basic identifying information about the subject of the SAR, the parties involved, and the fact that the filing institution is filing the SAR solely because the subject is engaged in an MRB and the fact that there is no additional suspicious activity related to the transaction. In addition, the narrative section of the SAR should include the phrase “Marijuana Limited.”

A Marijuana Priority SAR should be filed by a financial institution when the financial institution provides financial services to an MRB that the financial institution “reasonably believes, based on its customer due diligence, implicates one of the Cole Memo priorities or violates state law.” The Marijuana Priority SAR

should include more detailed information about the subject of the SAR and the parties involved. The SAR should also include details regarding the enforcement priorities the financial institution believes have been implicated and specific details about the financial transactions. Again here, the narrative section of the SAR should specifically include the phrase “Marijuana Priority.”

A Marijuana Termination SAR should be filed when a financial institution decides to terminate a relationship with an MRB in order to maintain an effective anti-money laundering compliance program, FinCEN expects the financial institution to file a Marijuana Termination SAR and note in the narrative the basis for the termination of the relationship. Financial institutions should also use the term “Marijuana Termination” in the narrative section of the SAR. Furthermore, if the financial institution becomes aware that the MRB is trying to move to a second financial institution, the first institution should consider using the section 314(b) voluntary information sharing permissions to alert the second financial institution of potential illegal activity.

The Three Tiers of MRBs

A Tier I MRB is product touching. Examples include businesses dealing in seeds, processing, product testing, planting and other elements of cultivation, and dispensaries. They typically have state license requirements. Tier I MRBs are generally considered the highest risk. As a result, they are held to the highest standards for compliance, and financial institutions that choose to bank these MRBs face significant compliance burdens as a result. This means enhanced due diligence requirements, as well as on-going monitoring and assessment. When it comes to an MRB definition, most people think of a Tier I MRB because they are most clearly marijuana-related businesses.

A Tier II MRB is directly supporting cannabis, or a business whose primary customers are Tier I MRBs. Examples include hydroponic suppliers, packaging suppliers, licensing consultants, industry associations, or marijuana software providers. It’s important to note that a Tier II marijuana-related business is not typically held to the same standard of compliance. However, financial institutions do still have requirements from FinCEN regarding providing Tier II MRBs financial services. This can make things tricky for bank compliance, especially if the business is not specifically using a payment processor for cannabis. Because most businesses don’t openly declare their interactions with Tier I MRBs, they could face repercussions if the financial institution finds out, including having their bank or merchant account de-risked and shut down.

A Tier III MRB has incidental business with Tier I or Tier II MRBs. This can be a matter of interpretation, but typical examples include lawyers, accountants, food delivery businesses, and property owners. The element of interpretation comes from what counts as incidental business. Accountants are generally seen as Tier III MRBs, but if an accountant specializes in cannabis businesses and targets those establishments for clients, they could be a Tier II MRB. As a result, their banking and payments could also be subject to the same concerns outlined above.

Closing Thoughts

As you begin creating your AML compliance protocol, there have been a few advisory and reports issues that would be worth your review as well to provide additional insight these include the 2018 Farm Bill, the June 2020 FinCEN Advisory Report, and the 2019 Guidance from Federal Banking Agencies. Restructuring and including additional AML/OFAC training in your policies and for your employees is a must, whether or not you make the decision to consciously work with these clients as unintentional touches from cursory customer exposure continues to increase.