

# CANNABIS BANKING



MEETING WITH YOUR REGULATORS



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AT ANY GIVEN  
MOMENT WE HAVE  
TWO CHOICES:  
TO STEP FORWARD  
INTO GROWTH OR  
TO STEP BACK  
INTO SAFETY

— Abraham Maslow

## BE PROACTIVE

The Objective of the Meeting

You've been doing the research. You've been collecting your data. You've been educating yourself on the benefits, risks and potential rewards of entering the cannabis banking market. Before you go any further, it is critical to get your regulators involved in your plans. Whether you are simply exploring the possibilities or have made a steadfast decision to move forward, proactively engaging your regulators is critical. You need to understand their supervisory expectations and experience with financial institutions offering cannabis banking services.

They need to get a sound understanding of how you have arrived at this moment. They need to get a comfort level that you have the regulatory health, knowledge, expertise and infrastructure in place to effectively manage the risk associated with banking a higher risk industry. These are the preliminary expectations...these are the building blocks toward meaningful discussion and understanding of the regulatory examination approach that will be utilized for your institution. Let's take this first step together...let's prepare for the conversation...

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# FRAMING THE DISCUSSION

As we've taken up the discussion around cannabis banking, we have stressed the criticality of a comprehensive risk assessment. Whether you are prepared to provide banking services to this sector, or would like to avoid it for the time being, you must assess your environment and understand your current risk in order to formulate your policies and due diligence.

The risk assessment should also help you frame the discussion with your regulators. As such, we have used our Sample Cannabis Banking Risk Assessment to walk you through the main components you should be prepared to discuss.



## A LITTLE COMMUNICATION GOES SUCH A LONG WAY

### **Legality, Supervision & Market Share**

Having a firm grasp of legalization and the definitions of marijuana, hemp and CBD, at a minimum, provides for the foundation of your program. You have to have a good understanding of legalization within your state and the entities charged with oversight. You may find that there is more than one oversight body (e.g. Department of Health, Department of Commerce, Department of Pharmacy, etc.).

You should also have an understanding of the number of financial institutions providing banking services to cannabis-related businesses (CRBs) on a national level as well as within your market. This is not an easy task as many institutions are not hanging a fan leaf in their window. The most consistent method to-date to get a sense for the number of financial institutions is to refer to the marijuana-related suspicious activity report (SAR) data published by FinCEN.

While the FinCEN data gives us a starting point to figure out the number of institutions filing marijuana-related SARs, it is not a true measure of those actively banking the sector. Keep in mind that a marijuana-related SAR may be filed by an institution that does not want to actively bank CRBs. There is undeniably an uptick in the number of financial institutions getting into this game, but the number may not be quite as high as those reported via SAR data.

When it comes to your specific market, you'll need to rely upon networking and peer groups, and perhaps some industry resources to get a sense for those who are banking CRBs.

The objective of this exercise is to look at potential market share. Will you be a market leader, or will you be following in the footsteps of those who have already established strong CRB relationships?

What does your competition look like? Remember, these CRBs are looking for basic banking services and are grateful

(and typically loyal) to those who give them a chance. They are not going to uproot an established account to come to your institution.

## Potential for Revenue and Liquidity

Banking a higher risk sector comes with the expectation that you will price for your risk. Have you considered how you will accomplish this? Financial institutions that are successfully banking CRBs tend to implement fee structures that cover the initial application and due diligence processes, as well as ongoing account administration. What is the risk to other sources of income?

You are looking at potentially sizable deposits coming your way. How will that impact your liquidity levels? How will you put those funds to use? Conversely, if you choose to exit such relationships, how will that impact your funding sources. Establishing well-supported in-house limits can help you control the impact of deposit influx or exodus.



## Defining Your Target Customers and Acceptable CRB Relationships

Who do you intend on banking? Do you know whether you are currently banking any CRBs? Those that are clearly CRBs (e.g. cultivators, processors and dispensaries) are relatively easy to identify, while those indirectly related may not be. How will you define CRBs and how will you determine those to which you will provide banking services? Will you provide banking services to employees of CRBs? And will you continue to provide banking services to existing customers that are now involved, directly or indirectly, in a CRB?

How will you address hemp and CBD given the passage of the 2018 Farm Bill and USDA oversight, combined with state- or tribal government-specific programs?

How will you address CBD distributors and retailers given the focus of FDA enforcement?

What if you want to avoid the cannabis space altogether? Is that even possible in the current environment?

These are critical questions to ask yourself as you build your case for your discussion with your regulators as the level of due diligence and how you will actually build your program will hinge on your answers.





## Assessing Your Regulatory Health

Being a market entrant, or a market leader, in a higher risk industry is not for the faint of heart. You need to be able to turn down the noise and the distraction of competing priorities to focus on your strategy, and the execution of that strategy. For this reason, you must self-assess your regulatory health. Fortunately, you have a sound guide in helping you do just that: You have your report card from your last regulatory examination, as well as the result of your most recent Bank Secrecy Act Audit. What do they say about your regulatory health?

other competing priorities. Do you have a merger or acquisition planned? Are you expanding into new markets or offering new products or services? These initiatives are important to the business of banking, but cannot simultaneously be executed while attempting to build a CRB infrastructure.

If there was any communication, formal or informal, from your regulators about areas within the bank that should get additional attention or should be refined, be sure to

### **IF YOU HAVE A "2" OR BETTER IN YOUR COMPONENT AND COMPOSITE RATINGS, YOU MAY BE WELL-POSITIONED TO BANK CRBS**

If you have a "2" or higher in your component and composite ratings, you may be well-positioned to bank CRBs.

When you have less than a "2" in a component or your composite ratings, you have supervisory priorities that must first be addressed...you have competing priorities and in the competition between regulatory health versus banking a new sector, guess which one is going to win.

Even with healthy component and composite ratings, you must consider

have those items outlined and your responses to each promptly prepared.

Take a look at your capitals levels. If you are not adequately or well-capitalized, you may not be positioned to build out a CRB program or absorb the associated risk. Understand any capital constraints you may have and be prepared to discuss how they could possibly be impacted by offering CRBs banking services. This is sure to be one of the questions your regulators will pose.



## Internal Buy-In

A united front is something to strive for. This may not be easy at first. You'll have Directors, officers and employees that may not support the idea of providing banking services to CRBs. The key is to get to the root cause. Is it the risk associated with doing so? Is it the discomfort with being out in front as a market leader? Is it the connotation they associate with the plant? By addressing internal concerns and their root causes before you talk with your regulators, you should be able to present a united front in how you would like to proceed as an institution.

## Expertise and Staffing Levels

Do you have the expertise in-house to develop the infrastructure (e.g. policies, procedures, due diligence, onboarding, monitoring, reporting, etc.)? If you have a BSA Officer who is willing and able to spearhead this effort, have you planned for additional departmental resources in terms of staffing and expertise? Have you researched third-parties that can help you achieve this mission? It is critical that the person(s) and/or department primarily responsible for CRB onboarding and administration has a sound support structure.

When looking at staffing levels, consider operational aspects of a CRB banking program. If you have an historically low-volume of SAR filings, you must plan for increased volume given marijuana-related SAR requirements.

You will also need to consider the strain on resources for currency transaction monitoring and reporting. Given that this is primarily a cash-based industry, and will be for some time to come, how will an increase in CTR filings test your staffing levels and resources?

## Technology Needs

Given the depth of due diligence, document collection and evaluation, and ongoing monitoring required to bank CRBs, you should be analyzing your technology needs. If you do not currently have a surveillance monitoring system in place, now is the time to act. These monitoring systems have become more cost effective in terms of implementation and subsequent validation. We would not recommend relying upon core reports that have historically been sufficient to manage a low risk profile.

You will need a more robust system that can help with the heavy lifting. If you have a surveillance monitoring system in place, how well suited is it to CRB banking? Has your vendor built in specialized parameters to capture cannabis-related activity, or to effectively monitor cannabis-related customers? If not, you may need to research some options for software specifically designed for CRB banking.

## **Issues with Non-Compliance**

While you hope for the best, you have to plan for the worst. What happens if your customer refuses to provide the information you need to effectively monitor them? What if lab tests show that THC levels are in excess of 0.3%? You must plan for these types of situations. What is your go-to response? You may consider account closing, or at the very least, limitations on transactions until the CRB comes back into conformance. Having a good answer to this question will go a long way in demonstrating that you've thought through the good, the bad and the ugly.

## **Reputational Risk**

Your reputational risk may correlate to how far along your state is with legalization. Many communities have embraced medical and/or adult use, while others are not quite on board. Knowing the posture of your communities is key.

Once you have an idea of how your provision of banking services to CRBs may be perceived, you can help to build your narrative. You can tell your story.

**"PUBLIC RELATIONS ARE  
A KEY COMPONENT OF  
ANY OPERATION IN  
THIS DAY OF INSTANT  
COMMUNICATIONS AND  
RIGHTLY INQUISITIVE  
CITIZENS"**

Alvin Adams  
Diploment 1804-1877



## Planning for Training & Audit

Whether you are planning to bank CRBs or not, training your staff is going to be critical to your risk control and mitigation. Only when your staff is knowledgeable can they effectively apply your due diligence procedures. Only when they are knowledgeable can they monitor for and identify critical activity. You will want to make sure that you have a detailed training program in place that extends bank-wide, from the front-line to the Board, to ensure all parties are knowledgeable of, and given the tools to effectively carry out, their respective responsibilities.

You will also want to revisit your BSA Audit function and discuss its scope with your auditor(s). If it does not include an assessment of your CRB banking activities, the scope should be expanded. You should also get a comfort level that your auditors have the expertise to assess the adequacy of your program. You may need to look for supplemental audit services to ensure appropriate coverage.

In addition to your BSA audit, you may also consider (and should consider) testing of your processes as you roll them out. If you have developed your CRB risk assessment, policies and due diligence, consider getting a fresh set of eyes on your program. Also consider testing of your onboarding process early on. By testing staff adherence to the policies and procedures you so diligently worked to establish, you can ascertain compliance early in the process, and take prompt corrective action, if necessary.



**NOW, YOU ARE READY.**

**TRUST THE PROCESS  
AND CELEBRATE EVERY  
VICTORY...**

