

# PUBLICATION

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## **It's Not Reefer Madness, It's Risk Management: Providing Investment Services to the Marijuana-Related Industry**

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**Investment advisors and broker-dealers ask more and more whether they can safely provide investment services to prospective customers in the marijuana industry. The answer is still that there is a risk of liability under federal law, but that the risk can be addressed by closely following guidance issued by the Department of Justice and FinCEN. How to manage the risk will change if the Department of Justice changes its enforcement priorities, which is discussed below.**

### **Managing Risk Based on Current DOJ Guidance**

Under the federal Controlled Substances Act, marijuana continues to be listed as a dangerous drug that is illegal to grow and distribute. Investment advisors and broker-dealers are affected by the Controlled Substances Act through the Bank Secrecy Act. The federal Bank Secrecy Act is an anti-money laundering law that provides for criminal liability against anyone who engages in a financial transaction knowing that the property involved represents proceeds from unlawful activity – in essence, the sale of marijuana is in violation of the Controlled Substances Act.

The Department of Justice, through its U.S. Attorneys, enforces the Controlled Substances Act and the Bank Secrecy Act. The DOJ's guidance to the U.S. Attorneys, which was issued during the Obama Administration and still in effect at this time, is that U.S. Attorneys should not focus DOJ resources on targeting financial institutions for providing services to cannabis-related businesses if the financial institutions did their due diligence on their customers pursuant to the Bank Secrecy Act.

The Financial Crimes Enforcement Network (FinCEN) issued a memorandum in 2014 (which is still in effect) providing guidance for how financial institutions could provide services to cannabis-related businesses while still performing their obligations under the Bank Secrecy Act.

First, investment advisors and broker-dealers needed to evaluate their own business objectives, risk tolerance and capacity to manage those risks effectively.

Second, investment advisors and broker-dealers must conduct extensive due diligence about the cannabis-related business to determine suitability and compliance with federal guidance and state law. This due diligence includes, among other things: (1) Verifying that the prospective cannabis-related business customer is licensed and registered with the appropriate state authorities; (2) Requesting and reviewing available information about the business and related parties from state-licensing and enforcement authorities; (3) Developing an understanding of what is normal and customary business activity; (4) Ongoing monitoring of publicly available information about the business and related parties; and (5) Ongoing monitoring of suspicious activity, including "red flags" set out by FinCEN.

Third, investment advisors and broker-dealers must file an appropriate Suspicious Activity Report (SAR) with FinCEN. As a predicate, a financial institution is required to file a SAR if, among other reasons, the financial institution knows, suspects or has reason to suspect that a transaction conducted through the financial institution involves funds derived from illegal activity. Because federal law prohibits the distribution and sale of marijuana, even funds derived from state-permitted businesses are considered funds derived from illegal

activity. Nevertheless, there are two types of SARs – "Marijuana Limited" and "Marijuana Priority" SARs – that require different levels of information and documentation depending on whether due diligence uncovers any of the red flags highlighted by FinCEN.

### **Managing Risk Based on Future DOJ Priorities**

On April 5, 2017, Attorney General Jeff Sessions issued a Memo to U.S. Attorneys. The Memo reiterated the DOJ's commitment to investigate, prosecute and deter violent criminals. The Memo also set out that a task force had been created to identify ways to better address violent crime such as gun crime, drug trafficking and gang violence. However, the Memo went on to state that the task force would be reviewing "existing policies in the areas of charging, sentencing, and marijuana to ensure consistency with the Department's overall strategy on reducing violent crime . . . ." There was no further mention of marijuana or its purported connection with violent crime.

At this time, then, the DOJ's official guidance to the U.S. Attorneys remains unchanged regarding marijuana businesses and financial institutions serving marijuana businesses. Therefore, investment advisors and broker-dealers can manage risk as outlined above.

Whether investment advisors and broker-dealers have to change how they manage risk for servicing marijuana businesses will depend on whether the DOJ's enforcement priorities against marijuana businesses change. Whether the DOJ's enforcement priorities change may depend on whether Congress supports the DOJ's focus on marijuana.

At this time, there is reason to believe that Congress will not support the DOJ enforcing federal law against duly licensed marijuana businesses under state law. In the temporary spending bill passed by Congress in spring 2017, Congress effectively prevented the DOJ from enforcing federal marijuana laws against legal businesses authorized by state law. The Consolidated Appropriations Act of 2017 contained the explicit provision that "None of the funds made available in this Act to the Department of Justice may be used, with respect to any of the States of [44 States were listed plus D.C., Guam, and Puerto Rico] to prevent any of them from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical marijuana."