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COMPLIANCE CONSIDERATIONS FOR MARIJUANA BUSINESSES

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ONE-ON-ONE INTERVIEW

COMPLIANCE CONSIDERATIONS FOR MARIJUANA BUSINESSES



Nick Parfitt

Head of Market Planning

Acuris Risk Intelligence

T: +44 (0)20 3741 1200

E: info@acuris.com

Nick Parfitt is responsible for determining Acuris Risk Intelligence's approach to the market and building subject-matter expertise. He has 18 years' experience in project and programme management, business process change and in implementing technology and business solutions at financial services, telecoms and public sector organisations. His experience in the financial crime sector spans seven years, helping tier one financial institutions assess and improve AML, KYC and sanctions operations. Mr Parfitt has worked for several tier one banks in the UK and holds an MBA (Distinction) from Cardiff University, and a BA (Hons) in Biochemistry from Imperial College.



R&C: How would you describe the regulatory and compliance challenges currently facing businesses in the regulated cannabis industry?

Parfitt: Regulatory and compliance challenges in this industry are very much dependent on the jurisdiction. There is a lot of variation around the world, and just because cannabis is legalised in one country does not necessarily mean that it is legal to do business from another country with entities that are involved in the industry. As it stands today, three countries have legalised the recreational use of marijuana: Canada, Uruguay and Portugal. The US poses a specific challenge: while most states have either legalised or decriminalised marijuana use, at a federal level it remains illegal. Consider the international dimension too, and the legality of doing business with legal marijuana-related businesses (MRBs). In Canada, for example, Deloitte estimates the value of the legal cannabis industry at approximately \$4.34bn in 2019. Could UK businesses participate? The UK's Proceeds of Crime Act (POCA) only considers whether the predicate activity – 'criminal conduct' – is legal in the UK, and not the legal status where it was undertaken. So, any revenue derived by a UK company from a Canadian MRB would constitute the proceeds of crime.

R&C: What legal and regulatory hurdles do marijuana businesses need to overcome when operating in this market? To what extent are dispensaries, growers and infused products companies struggling to meet these demands?

Parfitt: From a US perspective, the challenge remains in the banking sector and in anti-money laundering (AML) regulations, which make banks reluctant to do business with legitimate MRBs. While the federal government has been clear that banks can work with MRBs, they must file suspicious activity reports (SARs) regardless of whether or not the related state has legalised marijuana. This is further complicated by legal requirements to report on anyone depositing funds 'derived from illegal activity'. In theory, this even means a bank should file a report on a state government that derives taxes from legal MRBs. So if a dispensary cannot obtain banking and financial services, it will find it almost impossible to operate – banking cash, paying wages, and so on, just becomes too difficult. And, given this activity is still illegal at the federal level in the US, then businesses and individuals can still become a focus for federal law enforcement that can result in investigation and civil asset forfeiture for non-compliance. It is therefore imperative that MRBs understand their regulatory requirements and adhere to them so that financial institutions can successfully

comply with the Financial Crimes Enforcement Network's (FinCEN's) 2014 guidance and formula for assessing risk.

R&C: Have you seen an uptick in regulatory enforcement activity and scrutiny of compliance transgressions? What kinds of penalties might marijuana businesses expect to face if they are found to be in breach?

Parfitt: Just considering the US, to date reports suggest there has been no instance where federal law enforcement has cracked down on a legal cannabis operation, and there is little evidence either of increasing compliance transgression enforcement. The whole MRB industry is really in its infancy, but will change as marijuana licensing authorities know that the long-term survival of the industry requires enforcement of rules and regulations. The main challenge for MRBs operating legally is that they do not become the subject of traditional federal AML violations or non-compliance of regulations or state law, which could invite official federal investigation. Federal prosecution for money laundering remains a top concern for MRBs and the financial institutions with whom they have relationships. A recent example is the owner of a Maine company that is licensed to grow medical

marijuana but has a business association with an individual who is currently facing illegal firearm possession and marijuana trafficking charges in the federal district court in Maine. This association left the business owner open to allegations of non-

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*Nick Parfitt,
Acuris Risk Intelligence*

compliance with both Maine's medical marijuana laws and federal money laundering rules, as well as drug trafficking. The result is that some of the business owner's properties are subject to civil federal forfeiture, the business is undergoing federal investigation and a deal to acquire the company for \$8.3m allegedly fell through.

R&C: What essential advice can you offer to marijuana businesses looking to maintain compliance in the regulated cannabis industry? Do you believe they

need to do more to meet compliance requirements?

Parfitt: Be 'squeaky clean', know your compliance obligations and treat them very seriously, and expect your compliance spend to be significant. A good place to start is to understand FinCEN's guidance to financial organisations for customer due diligence compliance, and ensure that you are compliant. Furthermore, MRBs need to understand that they are still high-risk businesses and the relevant AML obligations should be 'baked' into everything they do, along with policies, procedures and controls to mitigate risks. Many companies that need to comply with AML regulations fall short in some way or another. Given the nature of this industry and its newness, we suspect there will be many gaps and, more importantly, a lack of real understanding from businesses as to what their regulatory obligations are.

R&C: What processes and tools should marijuana businesses consider as they work to remain compliant with regulatory requirements, and create a programme in which they can proactively manage associated risks?

Parfitt: The challenge currently for US MRBs is that compliance generally refers to state licensing

compliance requirements throughout the whole 'seed-to-sale' supply chain. There do not appear to be AML regulations on the MRBs themselves, but rather on the financial institutions that provide financial services to them. This supply chain is long and includes growers, processors, manufacturers, wholesalers and retailers who sell cannabis products to the end consumer. All parts of the chain must be compliant and ensure each is duly licensed. So, to be in a good place when it comes to demonstrating compliance with state licensing, businesses have a long list of obligations. This list includes performing due diligence, having a system to record each party within the supply chain, knowing who the beneficial owners are, identifying whether there is any reputational risk exposure hidden within any of the entities, and proactively monitoring these relationships. While MRBs are some way from being required to implement formal AML policies, there are lessons to be learned which will benefit their business practices and help meet future regulatory requirements. As with the Maine example, knowing your business relationships is very important, so enhanced due diligence should be applied where necessary.

R&C: To what extent are marijuana businesses struggling to keep pace with the operational costs of compliance? How can technology help to enhance or upgrade existing systems?

Parfitt: The issue for financial institutions is whether they have a business risk appetite to provide services to this sector given the current legal situation. Although revenues can be significant, so too can the cost of compliance. The opportunity is highly material. BDS Analytics forecasts legal cannabis spending in North America to reach \$47.3bn by 2027, with significant innovations predicted. Financial institutions need to look for supporting data and information to support their due diligence procedures in a more streamlined approach similar to due diligence performed on entities today under AML requirements. Who are the beneficial owners? What licences do they hold and under which state? Is there a reputational risk exposure? Current systems should be looked at to support this niche, but rapidly expanding, business segment so that appropriate controls can be implemented to achieve compliance.

R&C: What is the outlook for the regulated cannabis industry? Are compliance challenges set to increase over the months and years ahead?

Parfitt: Directionally, this industry is only going to go from strength to strength, albeit at different paces depending on the jurisdiction. In Canada,

initial public offering (IPO) activity for 2019 is likely to slow, according to Jason Wilson, a partner at ETFMG Alternative Harvest ETF, who states that this is likely due to the existing MRB companies that did achieve IPO in 2018 and now must deliver to their investors. In the US, while the legal stance is still precarious, the likelihood of federal investigations into businesses that can demonstrate that they are acting legally in their own states is waning. This follows the dismissal of attorney general Geoff Sessions, who was seen to be very biased against the legalisation of cannabis, the apparent endorsement by FinCEN, and the hope that a bill proposed in June 2018 by Charles Schumer gains traction. This bill would remove marijuana from its difficult place on the Controlled Substances Act list, effectively decriminalising it at a federal level. From a global perspective, there are some 26 countries where cannabis is in effect legal or decriminalised, and this trend is like to increase over time. In terms of compliance challenges, as with any AML programme, as a business becomes more complex and multijurisdictional, and as revenues increase, it will become more complex and expensive to ensure effective controls and to comply with each jurisdiction's nuances. **RC**