

Recent SEC AML Enforcement Actions' Impact on Compliance Efforts in the Cannabis Sector

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Investing in the cannabis industry is not without its risks, given the evolving regulatory landscape and the varying state and federal statuses of the product itself. The Financial Crimes Enforcement Network (FinCEN) has shown it will continue to enforce its 2014 Marijuana Bank Secrecy Act (BSA) Guidance, despite the rescission of the Cole Memo in 2018, which initially informed this guidance. Additionally, for public companies and other entities subject to oversight by the Securities and Exchange Commission (SEC), recent SEC enforcement cases reinforce the necessity of rigorous due diligence and adherence to anti-money laundering (AML) protocols, especially given that FinCEN maintains that all financial transactions involving marijuana remain federally illegal.

Enforcement Priorities Under the Cole Memo

When conducting due diligence on marijuana-related customers, financial institutions should determine whether the customer's activities align with any of the six enforcement priority areas outlined in the Cole Memo. FinCEN has advised financial institutions to apply these priorities to identify cannabis-related activities that must be reported to law enforcement^[1]:

1. Preventing distribution to minors: ensuring marijuana is not distributed to individuals under the legal age.
2. Revenue financing criminal enterprises: preventing the use of legal marijuana business revenue to fund criminal activities or the trafficking of other drugs.
3. Preventing violent activities: avoiding involvement in or association with violent activities related to marijuana.
4. Distribution to illegal states: preventing the distribution of marijuana to states where its sale remains illegal.
5. Public health consequences: mitigating adverse public health impacts, such as impaired driving due to marijuana use.
6. Cultivation on public lands: Preventing the cultivation of marijuana on public lands.

Where financial institutions find their customers engaging in any of the above activities, they must report those activities as part of their BSA compliance obligations.

Other Key Compliance Considerations

Due Diligence Requirements: Financial institutions are obligated to conduct thorough due diligence when assessing marijuana-related businesses for reportable activity. FinCEN's guidance emphasizes the following key requirements:

- Verification of state licensure: financial institutions must verify and review state licensure and application documents.
- Understanding business activities: institutions should develop a comprehensive understanding of the business's normal and expected activities, including product types and customer demographics.
- Ongoing monitoring: continuous monitoring of publicly available sources for adverse information and suspicious activity is essential.^[2]

Suspicious Activity Reporting (SAR): Financial institutions must file a SAR for any transactions involving marijuana-related businesses, whether that marijuana-related business is clear of the above-mentioned Cole Memo priorities. FinCEN has outlined specific SAR types — Marijuana Limited, Marijuana Priority, and Marijuana Termination — to address varying compliance scenarios.

- A *Marijuana Limited* SAR is appropriate where the customer follows state law and does not implicate one of the Cole Memo priorities.
- A *Marijuana Priority* SAR is appropriate where a customer's marijuana-related activity is either in violation of state law or implicated one of the Cole Memo priorities.
- A *Marijuana Termination* SAR is filed when the financial institution ends its relationship with a marijuana-related business

Ultimately, financial institutions must submit an SAR to FinCEN within 30 days after providing financial services to a business involved in marijuana-related activities — whether the institution believes the business is violating one of the Cole Memo priorities or state law.^[3]

Recent Enforcement Actions

The SEC has highlighted the importance of robust AML procedures through recent actions against financial firms for issues related to anti-money laundering (AML) compliance. Some of those charges included: misleading investors about a firm's AML/CFT policies; allowing sanctioned individuals to invest in a firm's fund; discrepancies between the firm's stated and actual due diligence practices; and inadequate customer identification processes.

Action Steps

- **Review and update AML policies:** ensure your AML policies are comprehensive and reflect current regulatory expectations, particularly concerning cannabis-related activities.
- **Enhance due diligence processes:** implement risk-based procedures to verify customer identities and monitor ongoing activities, ensuring compliance with both federal and state regulations.
- **Monitor regulatory developments:** stay informed about changes in the regulatory landscape to proactively adjust compliance strategies.

The evolving scrutiny of marijuana-related financial activities necessitates vigilance and proactive compliance measures. Firms must prioritize robust AML protocols to mitigate risks and avoid significant legal and financial repercussions.

For further guidance on navigating these complex regulatory requirements, please consult with our legal team at Troutman Pepper Locke.

[1] Financial Crimes Enforcement Network. “BSA Expectations Regarding Marijuana-Related Businesses.” FIN-2014-G001, February 14, 2014. <https://www.fincen.gov/sites/default/files/shared/FIN-2014-G001.pdf>.

[2] *Id.*

[3] *Id.*

Our Cannabis Practice provides advice on issues related to applicable federal and state law. Cannabis remains an illegal controlled substance under federal law.

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