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## **Financial Services to the Medical Cannabis Industry**

On March 30, 2023, Kentucky passed Senate Bill (“SB”) 47 legalizing medical cannabis in Kentucky. While implementation will not begin until 2025, financial institutions seeking to provide services to cannabis-related businesses (“CRBs”) should begin preparations to ensure compliance with the Bank Secrecy Act (“BSA”) and federal guidance.

### **What is a Cannabis-Related Business?**

CRBs are divided into two categories: directly related and indirectly related. A “direct cannabis business” is one that grows, produces, processes, distributes, or sells cannabis or cannabis products, edibles, or derivatives, regardless of the amount of the activity. An “indirect cannabis business” is one that derives any of its gross revenue from sales to direct cannabis businesses of products or services that could reasonably be determined to support the use, growth, enhancement, or other development of cannabis.<sup>1</sup>

### **Federal Guidance Regarding CRBs**

For financial institutions that engage in cannabis-related banking services, the primary compliance challenge remains the disconnect between federal and state law, as it is still illegal to manufacture, distribute, or dispense cannabis under the federal Controlled Substances Act (“CSA”). To address this incongruity, entities of the Federal Government have issued guidance as to compliance issues inherent in banking CRBs.

### **The 2013 Cole Memorandum**

In 2013, Deputy Attorney General James M. Cole sent the first of two memoranda to all United States Attorneys related to cannabis related prosecution priorities (collectively, the “Cole Memos”). This memorandum emphasized the Department of Justice’s (“DOJ’s”) commitment to

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<sup>1</sup> See Revised Guidance on Credit Elsewhere and Other Provisions in SOP 50 10 5(J)SBA Policy Notice 5000-17057 (April 3, 2018), available at: <https://www.sba.gov/document/policy-notice-5000-17057-revised-guidance-credit-elsewhere-other-provisions-sop-50-10-5j>

use its resources to address the most significant threats posed by cannabis and set forth eight enforcement priorities of the DOJ for civil and criminal enforcement:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law to states where it is not;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.<sup>2</sup>

### **The 2014 Cole Memorandum**

In February 2014, Deputy Attorney General Cole issued a second memorandum specifically addressing cannabis-related financial crimes. The 2014 Cole Memo stated that the money laundering statutes, unlicensed money remitter statute, and the BSA were still applicable to cannabis-related conduct. The 2014 Cole Memo further stated that financial institutions could be criminally liable under the BSA for failing to report financial transactions that involved the proceeds of cannabis-related violations of the CSA.<sup>3</sup>

While the Cole Memos were rescinded by Attorney General Jeff Sessions in 2018, subsequent Attorneys General have upheld and followed the guidance in the Cole Memos. The Cole Memos also provide the basis for the Financial Crimes Enforcement Network (“FinCEN”) guidance that applies to financial institutions today.

### **FinCEN Guidance**

In 2014, FinCEN issued guidance that instructed prosecutors to consider certain enforcement priorities with respect to BSA offenses related to CRBs. This guidance also provided a due

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<sup>2</sup> See James M. Cole, Memorandum for all United States Attorneys, Guidance Regarding Cannabis Enforcement (Aug. 29, 2013), available at: <https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>

<sup>3</sup> See Memorandum for all United States Attorneys, Guidance Regarding Cannabis Related Financial Crimes (Feb. 14, 2014), available at: <https://www.justice.gov/sites/default/files/usaowdwa/legacy/2014/02/14/DAG%20Memo%20%20Guidance%20Regarding%20Cannabis%20Related%20Financial%20Crimes%20%202014%2014%20%20282%29.pdf>

diligence checklist and articulated filing procedures for Suspicious Activity Reports (“SARs”) related to cannabis businesses.<sup>4</sup>

## **Guidance to Kentucky Financial Institutions Regarding CRBs**

Financial institutions planning to provide financial services to CRBs must adopt policies, procedures, processes, and practices tailored to the CRB industry, ensuring they align with the unique risk profile of these businesses, as well as with the prevailing federal guidance. Policies and procedures should include robust requirements related to customer due diligence (“CDD”) and enhanced CDD, the customer identification program (“CIP”), beneficial ownership, monitoring, suspicious activity reporting, and BSA risk assessment procedures.

### **Customer Due Diligence**

As with any individual or business entity, financial institutions must obtain basic identifying information about CRBs through the CIP and CDD processes, including beneficial ownership information collection and verification. When assessing the risk of each customer or potential customer - including assessing the risk of providing services to an CRB - financial institutions must conduct CDD, as this is a critical aspect of assessing and evaluating the risks associated with account holders. Pursuant to the 2014 FinCEN guidance, and specific to CRBs, this CDD should include:

- verifying with the appropriate state authorities whether the business is duly licensed and registered;
- reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its CRB;
- requesting from state licensing and enforcement authorities available information about the business and related parties;
- developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served;
- performing ongoing monitoring of publicly available sources for adverse information about the business and related parties;
- performing ongoing monitoring for suspicious activity, including for any of the red flags described in FinCEN’s guidance; and
- refreshing information obtained as part of CDD periodically and commensurate with the risk.

### **Bank Secrecy Act: Policies and Procedures**

Although SB 47 legalizes medical cannabis in Kentucky, the distribution and sale of cannabis is still prohibited under federal law. As noted in the 2014 Cole Memo and 2014 FinCEN guidance,

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<sup>4</sup> See Guidance, Dep’t of Treasury Fin. Crimes Enforcement Network, BSA Expectations Regarding Cannabis-Related Businesses (Feb. 14, 2014), available at: <https://www.fincen.gov/sites/default/files/shared/FIN-2014-G001.pdf>

financial institutions remain obligated to file an SAR consistent with FinCEN’s suspicious activity reporting requirements under the BSA. The requirement to file a currency transaction report (“CTR”) remains unchanged, and financial institutions must report currency transactions in connection with CRBs consistent with existing regulations.

2014 FinCEN guidance directs financial institutions serving CRBs to file one of the three types of SARs:

- A **Marijuana Limited SAR** should be filed when a financial institution determines, after exercising due diligence, that a CRB is not engaged in any activities that violate state law or that implicate the enforcement priorities outlined in the guidance.
- A **Marijuana Priority SAR** must be filed when a financial institution believes a CRB is engaged in activities that implicate the enforcement priorities. The FinCEN guidance also lists examples of “red flags” that may indicate that a Marijuana Priority SAR is appropriate, such as if a business fails to sufficiently document state law compliance.
- A **Marijuana Termination SAR** should be filed when a financial institution finds that it must sever its relationship with a CRB to maintain an effective Anti-Money Laundering program.

## **Conclusion**

Financial institutions must develop and implement policies, procedures, and processes to achieve compliance with BSA regulatory requirements and federal guidance. Financial institutions banking CRBs are likely to have an influx of CTR and SAR filings, and the Board must ensure sufficient resources are dedicated to maintaining strong compliance with the BSA. While banking CRBs heightens the risk profile, financial institutions can mitigate this risk by maintaining robust CDD, monitoring, and reporting processes, as well as retaining dedicated staff with the knowledge and expertise needed to effectively execute appropriate risk management policies and practices.