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# A case study regarding the processes for the selection of financial services vendors in the cannabis sector

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**MARCH 2022**

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## Introduction

Financial services for a cannabis business are tenuous, costly, and can be fraught with problems if a proper risk assessment is not completed. Identifying compliant and efficient vendors is an excellent example of a value add for the compliance officer and risk management position for the cannabis business. The purpose of this paper is to walk through the process of vendor due diligence and recommendations to senior stakeholders from the view of the compliance officer or risk management professional.

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***Helpful Hint- This assignment should be well within your wheelhouse. As a compliance or risk officer, you are well aware that you have a particular focus regarding the six “key control activities,” one of which is vendor management. There is also an overlap in compliance management and ensuring that you communicate non-compliance concerns to senior leadership. Download the document [HERE](#)***

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## Assignment

Company leadership has approached you and explained that they want to consider options in the payment sector for the convenience of their customers and to potentially boost sales. You are told to conduct due diligence on potential vendors that you find and add Paloma Pay to that list.

For our purposes here, I have chosen four potential vendors; two in crypto and two in the electronic payment sector or traditional atm space:

- Palomapay (palomapay.com) Crypto
- Potcoin (potcoin.com) Crypto
- ATM Pro (atmpro.com) Stand-alone atm
- Hypur (hypur.com) Electronic payment provider

As the project lead, I will take a risk-based approach to this assignment and begin by getting four copies of my vendor management form or logging into my program that has the form uploaded and start entering data on my potential vendors. I will gather information from these vendors and, over time, create a list of questions I want answered from my vendors to perform my due diligence work. I will also

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use a risk assessment form (if one is used) and begin to record pertinent information. As you see in this document, I did use a risk assessment form that I modified for this task.

Next, I am going to address ***inherent risk***. My list is as follows:

1. Some companies provide workarounds that are not compliant, and when they are discovered, accounts are shut down (actual court case)
2. Persons have been criminally prosecuted for providing false information to a financial institution to get an account (real court case)
3. Off-shore solutions may get shut down by various authorities in the USA, and our funds may be frozen for an extended time (actual court case)
4. Cash may be seized by way of civil forfeiture (actual court case)
5. An adverse regulatory action may arise if we are involved in a money-laundering scheme of our vendor
6. Vendors may advertise that their solution is compliant when in fact, it is not

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***Helpful Hint- Standardized terminology is essential in any industry so that when we use industry terms, we are communicating effectively. The Association of Certified Commercial Cannabis Experts (ACCCE) has an extensive glossary of terms that you can download [HERE](#)***

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As I interview my potential vendors, I am careful to speak to persons in authority that understand their business processes. I am looking for information regarding compliance and external audit issues that I will address before finalizing my findings for review. Although I will have a set of questions that I want to ask, I want to keep my options open to address additional concerns during the interview process. Remember, not all vendors have the same risks or levels of risk as you will see presented in this material. It is a mistake to apply the same risks and levels of risk to everyone in a blanket fashion. Vendors have different operational processes, and you will likely identify risks unique to that vendor/process that will require control activities unique to them. Other business types also present a different risk profile.

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## The Interview Process

I interviewed my potential vendors in a casual Q/A style and found that I developed questions during the conversation that were not on my list initially. I found that my interviews went smoothly, and the participants were helpful. They all seemed to have a good grasp of their procedures and were well versed in the compliance issues that I needed answers to. I was forthcoming with my own objectives because I wanted to set a good rapport with them and get candid answers from them. One of my interviewees was a bit hesitant to give me information. I explained to them that they conduct due diligence on my MRB to maintain their compliance, and so do I. If I cannot perform audits and establish information for purposes of assurance, then we will have to pass on them. Once I explained my "why," they had no problem with the process. Here are my takeaways from this process by vendor.

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*Helpful hint- Be ready to explain your "why" to potential vendors. Soliciting accurate information in a timely manner is important to your assignment*

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### PalomaPay

1. The representative was forthcoming
2. They have an app that is easy to download for the business and its customers
3. They do not hold funds, so they are not a custodian and likely do not need a money transmitter license
4. The purchasing customer makes a cryptocurrency purchase independently of PalomaPay
5. When a business accepts crypto as a payment, it can be instantly converted to USD
6. The transactions at the business level can be audited, and reports of transactions can be obtained
7. They do not itemize transactions, so the audit cannot determine what items were purchased
8. The name of the customer that makes the purchase is on the audit report

### Potcoin

1. I was not able to speak with anyone. They did not respond to my contact request
2. They are a traded entity and were down 10.23% on 3-2-2022
3. There are conversion fees involved in transactions

### ATM Pro

1. The representative was forthcoming, and we spoke on several occasions
2. They are a stand-alone ATM solution

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3. The business owner does not have keys to the equipment to "fill" the machine
  4. There is an average fee to the customer withdrawing funds of approximately \$3.00
  5. They monitor their machines remotely, so they know cash levels in the machine
  6. They have a customer loyalty coupon printing feature
  7. There are no fees for the MRB regarding transactions or equipment leasing
  8. There are no management fees
  9. There is a 48-month contract period
  10. They have audit capabilities for all transactions that I can use for in-house purposes
  11. They have authorization letters in hand from their ISO and participating FI
  12. Transactions on the purchaser's card will show "ATMPRO" as the vendor

## Hypur

1. Their representative was very forth-coming and the most knowledgeable regarding the payment sector of all that I spoke to
2. They are a compliance technology solution at their core
3. They are a true ACH solution
4. The consumer downloads the app and links their checking account
5. There is no holding of funds where Hypur is concerned
6. They perform a KYC on the customer that uses HYPUR to make a purchase
7. They perform a KYC and EDD on the MRB
8. They supply custom audits for my audit purposes

In addition to interviewing the potential vendors, I reached out to Brion Nazzaro of the Association of Certified Commercial Cannabis Experts. Mr. Nazzaro is a governance fellow and has specific expertise working in the banking/marijuana industry at the board, risk, and compliance levels. I believe it is important to reach out to industry experts to get a perspective of what they might look for and why. None of us know everything, and I cannot address what I do not know or identify. Here are my key takeaways from my conversation with Mr. Nazzaro:

1. Ensure the ISO provider information is in the contract for the MRB
2. Review the contract to determine if the company passes liability to you
3. Ensure you can reconcile the cash from the atm machine vs. what the MRB received for the same period
4. I want the ability to audit the hours of use of the atm for off-hour transactions
5. Ensure you can end the contract if your bank has an issue with your atm solution
6. Make sure you are honest with the information you provide and get a copy for your records
7. Money laundering is a risk if you don't know where their cash is coming from. You should understand how the vendor is sourcing their cash

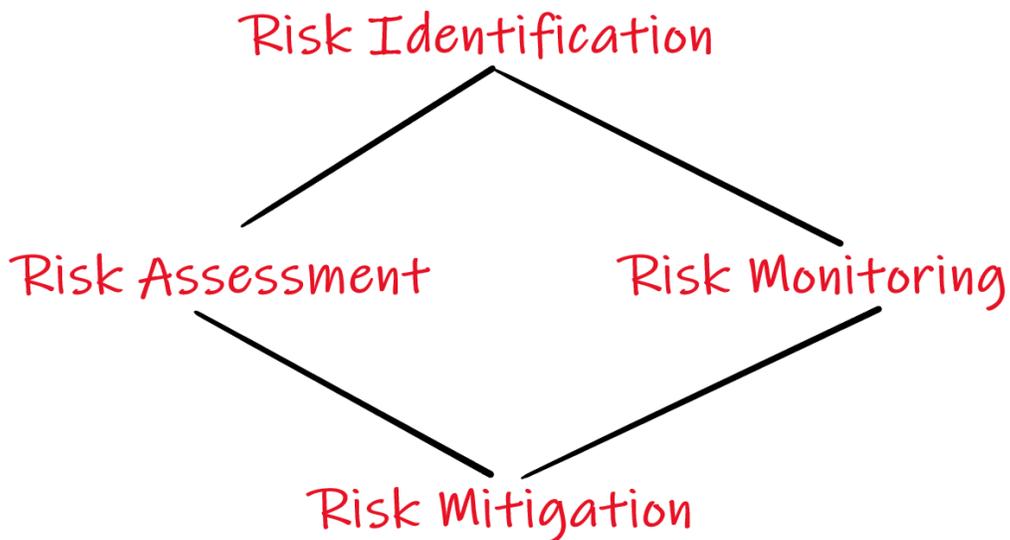
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I found my conversation with Mr. Nazzaro very enlightening, and I will incorporate that information into my vendor selection process, risk assessment, and audit processes. I will communicate various concerns to senior stakeholders.

## Completing my assignment

After the completion of my fact-finding processes, I completed my risk assessment that accompanies this report. Depending on the makeup of your business, you may want to confer with others in the compliance department, risk management, or senior management to get suggestions on what control activities they believe will be helpful from their department's perspective. Getting all relevant stakeholders involved is an important part of your job. One important aspect to remember is objectivity. Do not bring your particular prejudices into the process. Various senior stakeholders will be the decision-makers here. Your job is to bring them concise and objective information so that they are well informed and able to execute in the business's best interests.

**Consider this assignment from a risk-centric perspective**



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## Conclusions

The style and format of your work is up to you absent company forms. In this case, I used our standard risk assessment form and modified it for my work here. My focus here is primarily on the assessment process, developing control activities, etc. Be careful to maintain your objectivity and avoid prejudices you may have towards any number of things; vendor contacts, cryptocurrency, business processes, and the like. Some of the information I obtained from my vendor interviews were not risk related. An example of that is the coupon printing feature that ATM Pro has. My leadership views product features as an important part of their selection process. Knowing that, I will include this information in my report that accompanies the risk assessment forms.

I found it very valuable to interview Mr. Nazzaro, the banking and governance expert. He gave me insights into the process that assisted me in developing questions for my prospective vendors and some of my control activities. I am a firm believer in using outside experts to help in the process. I always end up with a better product at the end of the day, and my business will benefit from that.

My personal top vendor choice is Hypur. Their KYC process of the customer is a game changer from a compliance and risk mitigation perspective. Their granular reporting feature will be a big benefit to our business in terms of assurance of compliance.

The risk assessment process is fundamental and should not be undertaken in a cavalier fashion. You may be familiar with the payment processor scandal involving the marijuana delivery service "EAZE" in California. EAZE began taking credit cards and debit cards as payment for marijuana to the tune of \$150 million. In time, other businesses filed a lawsuit alleging unfair business practices. That led to criminal prosecution for the CEO of EAZE, a vendor, and an outside consultant. The matter was tried, and all three were found guilty, two being sentenced to prison.

A risk management and compliance program will return value to your business and help you avoid reputational risk, business interruptions, fines, and other adverse actions on the part of the regulatory sector and enforcement division. Protect your business and deliver on your business goals.



## Compliance Risk Assessment

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[Financial services vendor assessment for Barry's dispensary]

Version	Approval Date	Description	Author
One		Financial services vendor	Kirk Barry

## Risk Appetite

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Barry's dispensary has indicated that the level of risk they are willing to accept is low in alignment with their business objectives. They do not want to incur fines or any adverse actions by the various regulatory agencies that oversee their business. They would prefer to channel money meant for fines into a more robust risk management and compliance program to positively affect their business.

*The information presented is for informational purposes only and is not legal advice, is not to be acted on as such, may not be current, and is subject to change without notice.*

**RISK SUMMARY:**

1. There are companies that provide workarounds for accepting debit and credit card payments that are not compliant but purport to be compliant. When they are discovered, accounts are shut down which would have an adverse effect on our internal processes and cause reputational risk in the eyes of our customers. We may incur lost revenue as customers may become frustrated and shop elsewhere.

**INHERENT RISK:**

Low    Moderate    High

2. Providing false information to a financial institution of any type in order to get an account or a vendor may submit false information on our behalf. We risk criminal prosecution or an adverse civil action or regulatory fine or suspension of license. This will have a negative impact on our business goals and objectives and bring severe financial penalties and we will incur reputational risk

Inherent Risk:  
Low    Moderate    High

3. Some vendors may use offshore solutions regarding funds transfers, escrows, or banking. We risk having funds frozen for an indefinite period, being involved in a lawsuit, loss of funds for insolvency reasons of a vendor, or other adverse regulatory action. This will have a negative impact on our business goals and objectives, bring severe financial penalties, and we will incur reputational risk

**INHERENT RISK:**

Low    Moderate    High

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4. A vendor may take shortcuts or operate in a non-compliant fashion such as cash being transported. This may result in funds being seized by the enforcement sector in a civil forfeiture action. We risk loss of those funds and may find ourselves in a civil lawsuit. This will have a negative impact on our business goals and objectives and bring severe financial penalties and we likely incur reputational risk

**INHERENT RISK:**

Low Moderate High

5. A vendor may provide a non-compliant solution to accept cards for payment with the intent of using this equipment for Money laundering purposes. This would likely include collusion by other vendors involved in the transferring of funds. This may result in funds being seized by the enforcement sector or funds being frozen for an extended period. We risk loss of those funds and may find ourselves in a civil lawsuit. Money laundering risk is high here. This will have a negative impact on our business goals and objectives and will affect our cash flow. We will likely incur reputational risk

**INHERENT RISK:**

Low Moderate High

6. A vendor may advertise or infer that their solution or product is compliant when in fact it is not. This may result in adverse regulatory actions or negatively affect our operations. It may also cause customers to be frustrated and we may lose business as a result. This will have a negative impact on our business goals and objectives and may bring reputational harm

**INHERENT RISK:**

Low Moderate High

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	<ul style="list-style-type: none"><li>• Ensure vendor has proper licensing to transport cash in every jurisdiction that your cash travels</li><li>• Perform an external audit of all relevant processes including auditing terminals and downstream service providers such as ISO's, FI's and any custodian of funds. Verify the entire money trail</li></ul>		<ul style="list-style-type: none"><li>•</li><li>•</li><li>• Finance and legal should develop training regarding the flow of cash from the business to the FI and be directly involved in assurance</li></ul>	
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## QUALITY OF CONTROLS

Strong     Satisfactory     Unsatisfactory

## RESIDUAL RISK IN ATM AND PAYMENTS:

Low     Moderate     High

## RESIDUAL RISK IN CRYPTO:

Low     Moderate     High

## RESIDUAL RISK SUMMARY:

Having the paperwork in order that clearly states our business type and retaining a copy of that document will create a defensible record. Auditing the terminal at the various intervals will ensure the continued compliance of the vendor in this respect. Auditing cash withdrawn from the atm and comparing that to the business receipts will help address money laundering concerns. Working with finance to obtain granular information for audit purposes from our vendor of choice will be important to mitigate risk. Due to the price volatility of crypto and its lack of transparency regarding products purchased and KYC issues, I have assigned a higher residual rating. We should also look into insurance if a vendor is transporting our cash to a financial institution.

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