

2018 farm bill opens \$20 billion hemp industry to banks

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FEBRUARY 19, 2019

The passage of the Agriculture Improvement Act of 2018, commonly referred to as the farm bill, marked a significant shift in cannabis policy in the United States. The farm bill removed hemp from the Controlled Substances Act's definition of "marihuana"¹ and created a framework for individuals to begin cultivating hemp beyond the limited state-approved pilot programs permitted under the previous farm bill.

Put simply, Congress legalized hemp and derivative products containing no more than 0.3 percent tetrahydrocannabinol, also known as THC. This change has created the opportunity for farmers, growers, pharmaceutical companies, distillers and others to legally produce and sell hemp and its derivatives, including cannabidiol oil, commonly called CBD oil, and industrial products such as ropes, varnishes, paint, soaps, feed, textiles, paper and building materials.

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The wholesale legalization of hemp is good news for financial institutions. With the green light from Congress, the hemp industry is expected to grow to \$20 billion by 2022.

Most importantly, now that hemp is legal, financial institutions have the opportunity to transact with this largely untapped industry without operating in the legal gray area that previously kept most of them out of the cannabis market.

WHAT'S THE LAW?

The farm bill is an extensive piece of legislation that has two main impacts for hemp companies and the financial institutions that may now provide services to them. First, it removes hemp from the CSA's definition of "marihuana," which, in turn, removes it from its previous listing as a Schedule I narcotic.

The farm bill defines hemp as "the plant *Cannabis sativa* L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis."²

Thus, the designation as hemp turns on the THC content of the cannabis plant, rather than on the portion of the plant used to obtain cannabinoids such as THC or CBD, or the manner in which the cannabis is grown. Consequently, hemp can be divided into two broad categories.

The first are the cannabis plants typically referred to as industrial hemp, which are grown outdoors for their fibers and seeds and are best suited for use in ropes, varnishes, paint, soaps, feed, textiles, paper, building materials and other industrial products. These plants contain relatively low amounts of both THC and CBD, and they are generally not considered efficient sources for either cannabinoid.

The second category is phyto-cannabinoid rich hemp, which are artificially created strains of cannabis that are relatively high in CBD, low in THC and typically grown indoors. Because PCR hemp is more likely to exceed the 0.3 percent THC threshold, these products must be carefully grown to ensure they do not exceed the statutory definition of hemp.

Second, the farm bill expands the commercial cultivation of hemp beyond the limited state-approved pilot programs currently in place. Prior to the passage of the farm bill, states were only permitted to implement industrial hemp research pilot programs. These limited programs, however, were largely unable to meet the demand for hemp in the United States.

As a result, the United States imports an estimated \$100 million of hemp products each year. The farm bill aims to change that by allowing large-scale commercial production of hemp.

The farm bill largely gives the regulatory authority over the production of hemp to states. If a state wishes to have regulatory authority over hemp, it must submit to the secretary of agriculture a plan that includes procedures for:

- Maintaining hemp land records.
- Testing the THC concentration of hemp and its derivative products.
- Disposing of hemp and its derivative products grown in violation of the farm bill (i.e., producing hemp with greater than 0.3 percent THC concentration).
- Conducting annual inspections, including random sampling of hemp, to ensure compliance with the farm bill.
- Taking action in the event of negligent, culpable and repeat violations of the farm bill.
- Submitting records to the secretary of agriculture.

Importantly, the farm bill expressly does not preempt more stringent state laws related to hemp production. Thus, so long as a state includes the above-listed elements, it can implement additional, stricter regulations.

If a state chooses not to take on the regulatory authority or its plan is not approved, it will be subject to a plan established by the Department of Agriculture with the foundational elements listed above. The farm bill otherwise directs the secretary of agriculture to promulgate implementing regulations and guidelines.

EFFECT OF THE FARM BILL ON BANKING

While the farm bill does not directly address banking with the hemp industry, it nonetheless opens the door for financial institutions to transact with these businesses because it legalizes hemp's cultivation, manufacture, distribution and sale. The bill removes four main barriers that previously prevented financial institutions from transacting with cannabis-related businesses.

The first of these barriers was the CSA itself. The CSA establishes five categories or classifications, called Schedules, of regulated drugs, based on the drugs' potential for abuse, their accepted medical use and their treatment in international treaties. "Marihuana" is listed as a Schedule I narcotic — the most dangerous category of narcotics under federal law.

Manufacturing, distributing or dispensing cannabis is a violation of the CSA, as is conspiring with another to do so. Aiding or abetting another to violate the CSA is itself a crime, as is knowingly assisting a violator after the fact.

Fines and imprisonment are penalties for violations of the CSA, and anyone who conspires to commit an offense under it is subject to the same penalties as prescribed for the offense itself. The fines range from \$1,000 to \$2 million, and prison sentences range from less than a year to 10 years.

Because the farm bill removed hemp from the definition of "marihuana" and, in turn, removed its Schedule I classification, the CSA no longer operates on its face as a barrier to transacting with hemp businesses by potentially subjecting financial institutions to criminal liability.

As discussed more fully below, however, financial institutions should still take steps to ensure customers are not violating the CSA by growing, distributing or selling non-hemp cannabis products.

The second barrier was the uncertainty created by divergent state and federal cannabis laws. Despite the federal prohibition of cannabis, about 30 states have legalized cannabis to some extent.

To address this open split of state and federal law, the Obama-era Justice Department issued the Cole Memorandum, which de-prioritized enforcement against cannabis-related businesses operating in states where cannabis was permitted under state law.³

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Relying on the Cole Memorandum, the Treasury Department's Financial Crimes Enforcement Network issued guidance Feb. 14, 2014, clarifying how financial institutions could transact with cannabis-related businesses while remaining compliant with federal reporting obligations.⁴

The guidance requires financial institutions transacting with cannabis-related businesses to conduct substantial and continuing due diligence to ensure its cannabis customers are not violating the Cole Memorandum enforcement priorities or state law. It also requires financial institutions to file cannabis-specific suspicious activity reports.

Further muddying the waters, after President Donald Trump took office, then-Attorney General Jeff Sessions rescinded the Cole Memorandum.⁵ Although FinCEN ultimately reaffirmed that its guidance remains in effect, the uncertainty surrounding it, coupled with the increased due diligence requirements and federal prohibition of cannabis, has kept most financial institutions away from the cannabis industry.

The farm bill removes this uncertainty for hemp by firmly placing it on legal ground. Thus, financial institutions transacting with hemp businesses no longer have to operate in the legal gray area created by the complex web of divergent state and federal laws.

The third barrier was the Money Laundering Control Act, or MLCA, which prohibits the transfer of proceeds related to "specified unlawful activities," including violations of the CSA. Notably, any act "involving ... dealing in a controlled

substance or listed chemical (as defined in section 102 of the Controlled Substances Act)” is a specified unlawful activity, the transfer of proceeds from which could lead to a money laundering charge under Section 1956.⁶

Because hemp no longer falls within the definition of “marihuana” under the CSA, the underlying cultivation, manufacture, distribution or sale of hemp and its derivative products is no longer a “specified unlawful activity” under the MLCA. Consequently, the farm bill’s legalization of hemp minimizes the risk of running afoul of the MLCA.

The fourth barrier was the Bank Secrecy Act. The BSA places record-keeping and reporting requirements on statutorily defined “financial institutions” to assist the federal government in combating money laundering. The BSA requires financial institutions to report certain transactions, file suspicious activity reports when they know or suspect a violation of federal law or the BSA or detect suspicious transactions related to money laundering, and establish anti-money laundering compliance programs.⁷

Specifically, a financial institution must file a suspicious activity report if it knows, suspects or has reason to suspect that a transaction conducted through it involves funds derived from illegal activity, specifically including the production, distribution or sale of cannabis in the United States.⁸ Willful violations of the BSA reporting requirements can result in civil penalties ranging from \$25,000 to \$100,000 for each day a financial institution is noncompliant.

The BSA and FinCEN guidance discussed above place increased compliance and reporting requirements on financial institutions transacting with cannabis-related businesses. However, the trigger for these reporting requirements in the context of cannabis is the knowledge that the funds involved in a transaction are derived from illegal activity. Because cultivating, manufacturing, distributing and selling hemp is now legal, compliance with the BSA is far more manageable.

COMPLYING WITH THE NEW REGIME

While the farm bill removed many of the barriers that prevented financial institutions from transacting with hemp businesses, the regulatory regimes otherwise remain in effect and financial institutions must remain vigilant when transacting with hemp businesses. Thus, financial institutions should consult an attorney and build a robust compliance program tailored to the regions in which they operate before opening their doors to hemp customers.

While not an exhaustive list, there are several steps financial institutions should implement as part of a compliance program.

First, because hemp is defined based on the chemical makeup of the cannabis plant, financial institutions must take steps to ensure customers are not using the farm bill as a means to skirt federal law by exceeding the threshold set forth in the statutory definition of hemp. Once a customer leaves the confines of the farm bill, the CSA is controlling, and the same compliance issues that kept financial institutions from transacting with the cannabis industry re-emerge.

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Thus, financial institutions should maintain and periodically update their risk profiles of hemp customers to ensure they are not manufacturing or distributing cannabis products that fall outside the definition of hemp.

Second, financial institutions should include representations and warranties tailored to the hemp industry in their agreements with hemp customers.

Third, because the regulatory regimes related to the hemp industry are mostly left to states and largely yet to be defined, financial institutions must continue to keep abreast of state and federal regulations in this rapidly evolving space.

Specifically, financial institutions should tailor their compliance programs to each state in which they operate to account for locations with more stringent regulations. Relatedly, once a state promulgates regulations, financial institutions should take steps to ensure their customers are complying with state law, including the requirement for periodic on-site inspections.

TAKEAWAYS

Given banks’ constant pursuit of additional deposits, the farm bill’s opening of the floodgates to a potentially \$20 billion untapped industry is a significant development. The financial implications created by the farm bill, combined with the previous scarcity of financial institutions willing to engage with the industry, present a lucrative opportunity.

The farm bill, however, did not create a free-for-all allowing institutions to begin transacting with all medical or recreational cannabis companies. Thus, financial institutions must stay vigilant with their compliance regimes. The same motivation that kept them out of the state-legalized cannabis industry should guide them moving forward.

NOTES

¹ “Cannabis” and “marijuana” are often used interchangeably in common parlance. Technically, “marijuana” (sometimes spelled “marihuana,” as it is in the Controlled Substances Act and certain other federal documents) is a variety of cannabis sativa, one of the three subtypes of the cannabis plant. There is a trend toward using “cannabis” as the general term for marijuana, and this article follows that trend except in instances where “marijuana” is used to refer to laws or guidance documents using that term.

² Agriculture Improvement Act of 2018, Pub. L. No. 115-334 § 10113, 132 Stat. 44490 (2018).

³ Memorandum from James M. Cole, Deputy Attorney General, to all U.S. Attorneys, Guidance Regarding Marijuana Enforcement (Aug. 29, 2013), available at <https://bit.ly/1Rma2Ho>.

⁴ Guidance Letter, Fin. Crimes Enf’t Network, BSA Expectations Regarding Marijuana-Related Businesses (Feb. 14, 2014), available at <https://bit.ly/2pcGnrz>.

⁵ Memorandum from Jefferson B. Sessions, to all U.S. Attorneys, Marijuana Enforcement (Jan. 4, 2018), available at <https://bit.ly/2m04Ez1>.

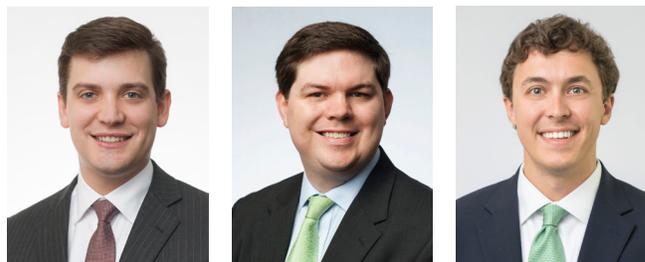
⁶ 18 U.S.C.A. § 1956(c)(7)(A); 18 U.S.C. §1961(1).

⁷ 12 C.F.R. § 21.11(a); see also 31 C.F.R. § 1020.320(a); 31 U.S.C.A. § 5313.

⁸ 31 C.F.R. § 1020.320(a)(2).

This article first appeared in the February 19, 2019, edition of Westlaw Journal Bank & Lender Liability.

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