

Weeding Through Industrial Hemp Laws for Indiana Banks

Amundsen Davis Financial Services Alert
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Since 1970, the Controlled Substances Act has proclaimed that any product derived from the Cannabis sativa L. plant is an illegal Schedule I controlled substance, including hemp. However, the 2018 Farm Bill makes a clear distinction between hemp and cannabis - while hemp and cannabis are both derived from the Cannabis sativa L. plant, hemp, by law, must contain no more than 0.3% Delta-9 Tetrahydrocannabinol (THC) by dry weight. THC is the psychoactive compound in cannabis that delivers a "high." The passage of the Farm Bill removed hemp from the list of Schedule I controlled substances and redefined it as an agricultural commodity, clearing the way for legalized industrial hemp, but with serious restrictions.

Indiana, like many other states, has passed laws legalizing and regulating industrial hemp. The Indiana Industrial Hemp Act permits the growth, production, and processing of hemp by a licensed individual or entity. Additionally, seed distributors possessing a valid seed permit are now authorized to sell certified agricultural hemp seed to growers. Importantly, without a license or seed permit, the Act treats hemp as cannabis, even if it contains less than 0.3% THC. But it isn't just hemp growers and seed distributors who are subject to strict regulation; the industrial hemp market includes transportation, financing, and manufacturing, among others - essentially every aspect of the industrial hemp market will be regulated.

Changes in federal and state laws have created confusion for financial institutions who want to engage in cannabis banking. In September, the Secure and Fair Enforcement (SAFE) Banking Act was passed by the House and a vote by the Senate is expected by the end of the year. The SAFE Act, in the form passed by the House, would offer "safe harbors" for banks providing services to cannabis-related businesses and also create protections for banks serving hemp-related businesses. Specifically, the SAFE Act would prohibit federal banking regulators from limiting or terminating deposit insurance and from incentivizing or encouraging banks to close accounts because the account holder is affiliated with a cannabis-related business. The SAFE Act would further instruct regulators to issue guidance and recommend best practices for financial institutions providing services to industrial hemp businesses.

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Until the SAFE Act becomes law, however; providing financial services to cannabis-related businesses technically remains illegal, and providing services to hemp-related businesses remains difficult and risky due to the legal confusion over their status. With Indiana's first crop of commercial hemp production expected in 2020, banks who "wait and see" what the outcome of the SAFE Act will be, might be missing out on valuable opportunities to engage with industrial hemp businesses. To remain competitive, Indiana banks should take a proactive approach to understand the legal requirements to operate in the industrial hemp market and augment their due diligence and risk assessment process to comply with the Bank Secrecy Act (BSA).

As part of their due diligence, banks should require documentation establishing that its customers hold valid licensure to participate in the industrial hemp market. Documentation may include copies of the customer's complete license and/or Indiana seed permit application packets, license and permit numbers issued by the Office of Indiana State Chemist (OISC), annual reports and field tests required by the OISC, and all organizational documents filed with the Indiana Secretary of State's Office. It is important to require copies on an annual basis as a hemp license or agricultural hemp seed production license must be renewed each year in accordance with rules adopted by the state seed commissioner.

Because banks are obligated to file suspicious activity reports (SARs) consistent with Financial Crimes Enforcement Network (FinCEN) guidance, ongoing monitoring of industrial hemp customers is crucial. Developing a risk assessment and transaction surveillance process allows banks to understand the customer's hemp business. A robust risk assessment should include the customer's reputation, credit, liquidity, operations, and compliance measures. A transaction surveillance process will enable banks to recognize the customer's ordinary and anticipated business activity, such as the frequency and amount of deposits and/or withdrawals made on the customer's account. Thus, if the bank knows, suspects, or has reason to suspect that an industrial hemp customer is transacting business outside the parameters defined under the 2018 Farm Bill or the Indiana Industrial Hemp Act, such as the distribution and sale of unlicensed hemp, it must file an appropriate cannabis-specific SAR: "Marijuana Limited," "Marijuana Priority," or "Marijuana Terminated."

The development of education and training programs for bank employees should be an essential part of the bank's policies and procedures regarding industrial hemp customers. At a minimum, bank employees must understand the difference between cannabis and hemp, and the applicable federal and state laws and regulations for customers engaged in industrial hemp businesses. Continued education and training are important as these laws evolve.

Until cannabis is legalized at the federal or state levels or legislation is passed to protect banks that provide services to cannabis-related businesses, banks are likely to continue to perceive banking the cannabis industry as a risk. But as the

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industrial hemp market continues to grow, those banks taking proactive steps to develop appropriate policies and procedures, enhanced due diligence, ongoing risk-based monitoring, and employee education and training programs stand to reduce their risk and profit from this incredible opportunity.

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