

# Client Alert

October 2019

## NCUA Issues Guidance on Banking Hemp

The NCUA has issued guidance for all federally insured credit unions that choose to serve hemp-related businesses. As a result of the Agricultural Improvement Act of 2018 (the 2018 Farm Bill), hemp is no longer a controlled substance at the federal level. The 2018 Farm Bill removed hemp from Schedule I of the Controlled Substances Act and reclassified it as an agricultural commodity, so long as its products do not have more than the federally allowed level of 0.3 percent THC. THC is the psychoactive compound providing the “high” in marijuana.

Hemp may not be currently produced legally, however, under federal law unless it is produced under the industrial hemp pilot provisions of the Agricultural Act of 2014 (the 2014 Farm Bill). For hemp production to be legal under federal law beyond the 2014 Farm Bill pilot, the USDA must first promulgate regulations and guidelines to implement the hemp production provisions of the 2018 Farm Bill. The NCUA noted it will issue additional guidance once those regulations are promulgated.

With the enactment of the 2018 Farm Bill, hemp may be grown only (1) with a valid USDA-issued license, (2) under a USDA-approved state or tribal plan or (3) under the 2014 Farm Bill industrial hemp pilot authority. The pilot authority will expire one year after the USDA establishes a plan for issuing USDA licenses under the provisions of the 2018 Farm Bill. The 2018 Farm Bill preserves the authority of states and Indian tribes to enact and enforce laws regulating the production of hemp that are more stringent than federal law. Thus, while a state or an Indian tribe cannot block the shipment of hemp through that state or tribal territory, it may continue to enforce state or tribal laws prohibiting the growing of hemp in that state or tribal territory.

The NCUA guidance is intended as interim guidance and will need to be updated once forthcoming regulations and guidelines are finalized by the USDA, which will likely not occur until 2020. The global market for hemp consists of more than 25,000 products in nine submarkets: agriculture, textiles, recycling, automotive, furniture, food and beverages, paper, construction materials and personal care (including CBD oil).

The NCUA noted that credit unions that choose to serve hemp-related businesses need to understand the complexities and risks involved. The credit union must have a Bank Secrecy Act and Anti-Money Laundering compliance program commensurate with such complexities and risks. The NCUA stressed a few areas for credit unions to focus on:

**Due Diligence.** Credit unions need to maintain appropriate due diligence procedures for hemp-related accounts and to comply with BSA and AML requirements to file Suspicious Activity Reports (SARs) for any activity that appears to involve potential money laundering or illegal or suspicious activity. Credit unions need to remain alert to any indication an account owner is involved in illicit activity or engaging in an activity that is unusual for the business.

**Legal Compliance.** If a credit union serves a hemp-related business operating lawfully under the 2014 Farm Bill pilot provisions, it is essential that the credit union knows the state’s laws, regulations and agreements under which the member’s hemp-related business operates. A credit union must verify the basis of how the member is a part of the pilot program. Otherwise, it may be providing banking services for

an illegal activity. They must also adapt their ongoing due diligence and reporting approaches to any risks specific to participants in the pilot program.

**State Law.** Before commencing any banking relationship with a hemp-related business, the credit union must first become familiar with any other state and federal laws that prohibit, restrict or otherwise govern these businesses and their activity. For example, certain hemp-related products may now or in the future be subject to state health departments as well as the US Food and Drug Administration. This would include CBD products.

Serving hemp-related businesses includes both deposit activities and lending activities. Lending activities must comply with the member business lending regulations and be conducted in a safe and sound manner. Credit unions should not lose track of the fact that borrowers that are heavily dependent on products subject to state and federal law could be negatively affected by future regulations, particularly those requiring them to destroy product exceeding federal and state THC levels.

### **Risk Protection**

To mitigate risks with respect to serving hemp-related businesses a credit union should implement an effective Compliance Management System (CMS) in which the credit union “onboards” the member consistent with its procedures for higher-risk members and which includes:

- Performing initial diligence on the legality of the activities, including state licensing
- Ongoing monitoring of hemp customers
- Developing specific risk tolerances for both credit- and deposit-related hemp customers
- Obtaining contractual covenants and obligations from hemp customers

Credit unions entering into this space should build out a CMS with hemp-specific policies and procedures designed to ensure that the hemp business members are operating within the credit union’s established risk parameters and operating under applicable law. Credit unions should also develop policies and procedures to comply with guidance from the Financial Crimes Enforcement Network (FinCEN) if the hemp’s THC content exceeds legal thresholds or if the member is determined not to be operating in compliance with federal or state law, in which case the credit union may need to implement measures with respect to the member, potentially including the filing of an SAR. The key to enforcing the credit union’s CMS with respect to a particular hemp customer is through contract. Credit unions banking hemp need to address legal and compliance requirements through a supplemental agreement with those customers.

In making a decision to bank hemp-related businesses, credit unions should consider, among other things:

- Does the customer have all licenses and sufficient controls to monitor its legal compliance, including compliance with federal and state law regulations regarding destruction of the product if the THC content exceeds 0.3 percent (note that these regulations are still being developed)?
- Will the product, or funds from the product, cross state lines? If so, is the product or activity legal in the surrounding states? Have the customer’s hemp industry counterparties obtained all necessary licenses?
- Does the credit union have sufficient collateral if lending to hemp-related businesses, given that the product may have to be destroyed or be subject to forfeiture and seizure (along with other assets of the borrower) if the THC content exceeds 0.3 percent?
- Will the credit union be processing payments for hemp members, potentially implicating card network rules?
- Does the credit union have flexibility to alter its arrangements with a member as federal and state regulations are issued with respect to hemp?

- Did the credit union obtain board of directors approval of hemp banking activity generally and develop board reporting specific to hemp consistent with its existing MIS?

Navigating the hemp landscape can be accomplished through effective risk management. We have advised financial institutions on implementing CMS for higher-risk customers. Doing so, however, will require adjustments and tailoring within a credit union's CMS and agreements with customers prior to commencing the activity to effectively manage the risk. Please do not hesitate to contact Richard Garabedian at 202-419-2117 or Heather Archer Eastep at 202-955-1954 for further information.

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