



Professional Perspective

# Hemp Businesses and Financial Institution Due Diligence

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# Hemp Businesses and Financial Institution Due Diligence

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On June 29, 2020, the Financial Crimes Enforcement Network (FinCEN) issued [guidance](#) explaining how financial institutions can conduct due diligence for hemp-related businesses and identifying the type of information and documentation financial institutions can collect from hemp-related businesses.

Although financial institutions are given considerable discretion with regard to how they conduct customer due diligence, failure to examine the information suggested in the new guidance could result in violations of a financial institution's Suspicious Activity Reporting obligation. Despite the risks, with appropriate due diligence, financial institutions can safely provide financial services to hemp-related businesses.

## Background

In December 2019, the Agriculture Improvement Act of 2018 (Farm Bill) removed hemp as a Schedule I controlled substance under the Controlled Substances Act. It also directed the U.S. Department of Agriculture, in consultation with the U.S. Attorney General, to regulate hemp production. On Oct. 31, 2019, the USDA issued an interim final rule to implement the hemp-related provisions of the 2018 Farm Bill. The interim final rule establishes a federal licensing plan for regulating hemp producers in states and tribal territories that do not have their own USDA-approved plans. Nothing in the 2018 Farm Bill or the USDA's interim final rule preempts a state's decision to prohibit the possession, cultivation, or sale of hemp.

The 2018 Farm Bill and the USDA interim rule had a profound effect on the legal status of hemp-related businesses and their relationships to their financial institutions. In turn, federal and state banking agencies issued an interagency [statement](#) on providing financial services to customers engaged in hemp-related businesses. The interagency guidance reminds banks that hemp is no longer a Schedule I controlled substance under the Controlled Substances Act (CSA) and, therefore, banks are "not required to file a Suspicious Activity Report (SAR) on customers solely because they are engaged in the growth or cultivation of hemp in accordance with applicable laws and regulations."

Moreover, banks are reminded of their applicable regulatory requirements for customer identification, suspicious activity reporting, currency transaction reporting, and risk-based customer due diligence, including the collection of beneficial ownership information for legal entity customers.

## FinCEN Guidance

FinCEN's 2020 guidance supplements the interagency guidance, which first reminded banks of their due diligence responsibilities, by explaining how financial institutions can conduct due diligence for hemp-related businesses, and how they can identify the type of information and documentation financial institutions can collect from hemp-related businesses to comply with Bank Secrecy Act (BSA) regulatory requirements.

In many ways, this guidance mirrors FinCEN's 2014 [guidance](#) on BSA Expectations Regarding Marijuana-Related Businesses. In both pieces of guidance, FinCEN encourages financial institutions to verify the licensing status of their marijuana- or hemp-related customers. Both indicate that this verification is a critical element of a bank's customer due diligence (CDD) obligation.

Under a 2016 rule change, banks and certain other financial institutions are required to establish policies and procedures to conduct ongoing customer due diligence to understand the nature and purpose of the customer relationship to build a risk profile of the customer and to identify and report suspicious activity. In other words, the bank must conduct sufficient due diligence such that they do not knowingly or negligently facilitate the crime of money laundering and have a sufficient understanding of the customer to be able to detect anomalous activity. The penalties on a bank for failing in either of these efforts can involve significant fines and forfeitures and, in some cases, prison sentences for offending bank officials.

## Managing AML Risk

The 2018 Farm Bill descheduled hemp as a controlled substance, meaning its production and sale (licensed or unlicensed) does not violate the CSA. It is therefore not be a predicate offense to the federal crime of money laundering. One might ask why, if that is the case, banks should care if a hemp-related customer is appropriately licensed or not? Reasons may include:

- State laws considering hemp a controlled substance may still apply, meaning its production and sale could be considered a criminal offense and a predicate crime under state money laundering criminal statutes.
- As an agricultural substance, hemp may contain variable levels of THC. It would be easy for a hemp producer to accidentally produce marijuana (a controlled substance) instead of hemp (which is not).
- While the Farm Bill and the USDA's interim final rule do not explicitly place criminal penalties on non-negligent violations of the hemp licensure regime at a federal or state level, such violations may result in referrals to federal and state law enforcement agencies. If these referrals result in criminal charges against a hemp producer, collateral charges, such as aiding and abetting or conspiracy charges, could arise for the bank providing services to that hemp producer, even if the specific elements of a money laundering charge are not met.

Confirmation of a hemp-related customer's licensing status will help to mitigate all of these risks for the bank. Not only would the bank be able to assess the customer's status under state law, it would also gain a level of assurance that licensed hemp-related customers are required to manage their exposure to marijuana. A condition of licensure under the USDA interim rule is the inclusion of controls to ensure that a licensed producer tests for and disposes of any non-compliant product, which is backstopped by audit and oversight.

This recommendation assumes that no other risk factors, beyond a customer's involvement in the hemp industry, are present. However, financial institutions should be prepared to implement additional due diligence or controls when other risk factors are present, either alone or in combination, such as:

- The hemp-related customer is operating in a jurisdiction where the jurisdiction authorizes the production, sale, and/or possession of marijuana, in addition to hemp.
- The hemp-related customer is affiliated with a marijuana-related business through common ownership or control.
- The hemp-related customer conducts financial transactions with persons that are more commonly associated with the marijuana industry.
- The hemp-related customer was the subject of a "Marijuana Priority SAR," under FinCEN's 2014 guidance.

In such circumstance, it would be prudent for the financial institution to conduct the additional due diligence suggested by FinCEN in its 2020 guidance, including review of crop inspection or testing reports, license renewals, updated attestations from the customer, or correspondence from relevant authorities. Financial institutions may also implement greater scrutiny of the hemp-related customer's transactions to identify other potential risk factors and detect and report suspicious activity.

## Complying with SAR Obligations

Though risk remains, the descheduling of hemp significantly reduces a bank's exposure to criminal liability under the CSA and anti-money laundering criminal statutes. A bank's SAR obligation, however, is not limited to reporting of serious money laundering and its specified predicate offenses. Rather, the bank must report any suspicious transaction "relevant to a possible violation of law or regulation."

Therefore, a customer that produces hemp without a license would be in violation of the USDA's interim final rule and any transaction of that customer by, at, or through the bank may be reportable as a SAR. A bank that does not confirm a hemp-related customer's license status would be unable to detect such a suspicious transaction and could be deemed to have an ineffective and insufficient SAR program. However, the simple act of checking the license provides the bank with sufficient information to evaluate the integrity of a hemp-related customer's transactions.

## Conclusion

Despite the descheduling of hemp, there can be significant money laundering risks associated with providing financial services to hemp-related businesses. However, as FinCEN highlights in its recent guidance, the appropriate due diligence can “enhance the availability of financial services for, and the financial transparency of, hemp-related businesses in compliance with federal law.”