



# Illinois Department of Financial and Professional Regulation

## Division of Banking

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### MEMORANDUM

**TO:** All Illinois State-Chartered Banks and Savings Banks

**FROM:** Illinois Department of Financial and Professional Regulation, Division of Banking

**DATE:** July 25, 2019

**SUBJECT:** Industrial Hemp

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### SUMMARY

The Division of Banking (DOB) of the Illinois Department of Financial and Professional Regulation (IDFPR or Department) continues to support state-chartered banks and savings banks establishing, maintaining, and growing business relationships with participants in the industrial hemp market. This memorandum provides information and guidance on the latest industrial hemp legislation at both the federal and state levels. Currently, federal regulation and examination procedures provide limited direction to state-chartered banks and savings banks regarding BSA/AML requirements for hemp business customers.

### BACKGROUND

Historically, Illinois farmers were major hemp producers until tax and licensing regulations passed in 1937 made cultivation much more difficult for farmers. Then in 1970, growing hemp was effectively outlawed when industrial hemp was treated as indistinguishable from cannabis after the passage of the Controlled Substances Act of 1970. In 2014, Congress tried to revive the hemp market when it passed the 2014 Farm Bill (Public Law 113-79). The bill defined industrial hemp as “the plant *Cannabis sativa* L. and any part of such plant, whether growing or not, with a delta-9 tetrahydrocannabinol [i.e. “THC”] concentration of not more than 0.3 percent on a dry weight basis.” The bill authorized individual states to launch industrial hemp pilot programs for research purposes. However, the bill left open many questions regarding the continuing application of federal drug control statutes to the growth, cultivation, manufacture, and distribution of industrial hemp products. It also did not remove industrial hemp from the federal government’s list of controlled substances.

The 2018 Farm Bill (Public Law 115-334) went a step further and removed industrial hemp from the definition of “marijuana” in the Controlled Substances Act (CSA). As a result, regulatory authority over industrial hemp shifted from the Drug Enforcement Agency (DEA) to the United States Department of Agriculture (USDA). It is anticipated that hemp will be treated similarly to other legal crops, although licenses may still be required to grow hemp that are not required for other crops. (A few additional

caveats also exist based on hemp's previous status as a controlled substance and the potential for unscrupulous growers to cultivate strains of hemp with high THC levels.)

The USDA intends to promulgate regulations in Fall 2019 regarding commercial production of industrial hemp. Subsequently, each state wishing to permit commercial hemp production will have to submit a production plan for approval by the USDA.

Illinois passed the Industrial Hemp Act in 2018 (Public Act 100-1091). Under the 2014 and 2018 Farm Bills, farmers, universities and the Illinois Department of Agriculture can grow hemp in Illinois so long as there is a research component associated with the growth and the grower obtains an industrial hemp license.<sup>1</sup> If Illinois' commercial hemp production program is approved by the USDA, then the research component may no longer be required.

In summary, the 2018 Farm Bill made several substantive changes to the regulation of hemp:

1. it removed hemp from the Controlled Substances Act;
2. it permitted states with existing hemp pilot programs to continue operations; and
3. it instituted a procedure for states to create commercial hemp production programs upon federal government approval.

➤ **Note:** There are still many aspects that must be determined at the federal level such as testing protocols and data sharing agreements between states and the USDA.

## **ILLINOIS BANKING**

The 2014 Farm Bill and the subsequent 2018 Farm Bill should make banking in the industrial hemp space more tenable for a larger number of institutions. Hemp's removal from the Controlled Substances Act should decrease the regulatory risk and burden on State banks and other State financial institutions. Furthermore, states are granted the authority to regulate and limit the cultivation, production, distribution and sale of hemp within their borders. Correspondingly, Illinois' hemp pilot program (Ill. Ann. Stat. ch. 720 § 550/15.2) and commercial production program (Public Act 100-1091) develop a framework for hemp related businesses in the State.

### *Risk Management:*

In the first 24 hours that the Illinois industrial hemp application went live, the Illinois Department of Agriculture received nearly 400 applications<sup>2</sup> to grow or process industrial hemp. Faced with this new business demand, banks will need to adapt and develop policies amidst the evolving regulatory landscape as federal and state agencies work to implement this fundamental change in the law.

The decision to provide banking or financial services to the industrial hemp industry is a risk management proposition. Financial institutions need to be able to adequately gauge risk for all clients and potential clients, and the industrial hemp market is no exception. Regarding industrial hemp customers, financial institutions should, at a minimum, verify that the business is operating with the required state license and following the state's industrial hemp program rules. Banks should also perform continuing due diligence, including but not limited to obtaining available reports on crop testing and checking for any enforcement actions taken against the customer.

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<sup>1</sup> The Illinois Department of Agriculture began accepting applications for licenses on April 30, 2019.

<sup>2</sup> [https://agrlicensing.illinois.gov/Industrial\\_Hemp/](https://agrlicensing.illinois.gov/Industrial_Hemp/)

The removal of hemp from the list of controlled substances should make regulatory compliance easier and less expensive. In particular, because hemp was previously considered a Schedule 1 narcotic under the Controlled Substances Act – the most dangerous category of narcotics under federal law – providing financial services to hemp market clients implicated potential violations of the Controlled Substances Act. Those potential CSA violations also gave rise to increased requirements and risks under the Money Laundering Control Act and Bank Secrecy Act. Now that hemp has been removed from the Controlled Substances Act, the risk of running afoul of the Money Laundering Control Act is minimized and institutions are no longer required to file suspicious activity reports under the Bank Secrecy Act simply because the customer is engaged in the hemp business.

DOB examiners will continue to evaluate compliance with BSA/AML laws during regular safety and soundness examinations of state-chartered banks and savings banks. DOB considers state-chartered banks or savings banks' obligations under BSA/AML for hemp customers satisfied if the institution:

- Continues compliance with existing BSA/AML statutes.
- Implements an effective Customer Identification Program (CIP).
- Employs reasonable and effective enhanced due diligence procedures.
- Files Suspicious Activity Reports (SAR) when appropriate (for example, if a crop exceeds the legal limit of 0.3% THC).

If you have further questions regarding issues related to providing banking services to customers engaged in the hemp industry, please contact IDFPR.

### **THE DEPARTMENT'S PERSPECTIVE**

Industrial hemp has the potential to grow into a multi-billion dollar industry, and Illinois is well-positioned to be a significant participant in that market. The Department continues to support responsible and legitimate businesses, including those who deal with the cultivation, production, distribution and sale of hemp-related products. Although industrial hemp is now legal, and some regulatory obligations have been reduced, the market will continue to be subject to particular regulation at the state and federal levels. It is critical that financial institutions stay up to date with the latest regulatory developments. We expect the Fall 2019 USDA rules to provide an overarching set of federal regulations under which all hemp businesses must operate. Moreover, while the Department supports businesses that deal with hemp-related products, financial institutions are advised to ensure that their business practices meet the obligations that currently exist under state law.

#### *References:*

**Bank Secrecy Act** (31 U.S.C. § 5311 to § 5314) - The Bank Secrecy Act (BSA), also known as the Currency and Foreign Transactions Reporting Act, is legislation passed by the United States Congress in 1970 that requires U.S. financial institutions to collaborate with the U.S. government in cases of suspected money laundering and fraud.

**Money Laundering Control Act** (18 U.S.C § 1956 and 18 USC § 1957) - The Money Laundering Control Act (MLCA) was passed in 1986 and designated money laundering as a federal crime. Section 1956 prohibits individuals from engaging in a financial transaction with proceeds generated from "specified unlawful activities" (SUAs). Moreover, the law requires that an individual specifically intend in making the transaction to conceal the source, ownership or control of the funds. Section 1957 prohibits spending more than \$10,000 derived from an SUA regardless of intent to disguise the source.

**31 C.F.R § 1020.220** - Customer identification programs (CIP) for banks, savings associations, credit unions, and certain non-Federally regulated banks are designed for a bank to know the identity of each customer. All banks must have a written CIP that is appropriate for its size and type of business. The CIP must be incorporated into the bank's BSA/AML compliance program subject to the bank's board of directors' approval. Banks should conduct a risk assessment of their customer base and product offerings.

**31 C.F.R. 1010.620** - Due Diligence policies, procedures, and controls for detecting and reporting known or suspected money laundering or suspicious activity.

### **ADDITIONAL CONSIDERATIONS**

**Federal Crop Insurance** (7 U.S.C. § 1502 *et seq*) - Hemp crops now qualify for federal crop insurance, a voluntary insurance program that guarantees partial payment for crops lost to catastrophic events. Access to federal crop insurance will provide more certainty for cultivators in contracting for sale of their harvests.

**Liquidation Difficulty** - Industrial hemp's position under federal law also gives rise to collateral considerations for banks. First, because growers, processors, and handlers must be licensed to sell industrial hemp, a bank may have difficulty liquidating the industrial hemp in the event of default. A crop which tests above the 0.3% THC content threshold is illegal. Thus, a bank that takes an industrial hemp crop as collateral also bears the risk that a non-compliant crop could be non-eligible for sale or even ordered destroyed. According to the Illinois Department of Agriculture, if a crop tests between 0.3% and 0.7% in THC content on its initial testing, a secondary test is allowed. If the second test result is above the 0.3% THC content threshold, then the crop must be destroyed. There is also a 5-strike limit where if a company's crops fail the THC content test or they are found to be out of compliance with other licensing guidelines or requirements, their license may be suspended after the fifth violation.

**Transportation Protocol** - There is currently no transportation protocol for cultivators and distributors to follow when transporting industrial hemp across state lines. Only a patchwork of state regulations pertaining to moving industrial hemp across their borders exists, resulting in skyrocketing compliance costs for cultivators and distributors.

**Cannabidiol (CBD)** - The law is still unsettled on the U.S. Food and Drug Administration's (FDA) position regarding hemp-derived CBD oil use as a food ingredient or dietary supplement. The 2018 Farm Bill does not impact the FDA's authority to regulate hemp products or alter the regulatory requirements for FDA products such as food, dietary supplements, cosmetics, or drugs.