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BANK WATCH

QUARTERLY UPDATE ON LEGAL ISSUES IN BANKING

Banking the Cannabis Business in Virginia: Recent Developments

Banks seeking clarity on serving cannabis-related businesses in Virginia without running afoul of anti-money laundering laws can find help in recent federal and state regulatory actions regarding industrial hemp activities.

The Agriculture Improvement Act of 2018, also known as the 2018 Farm Bill ("Farm Bill"), legalized the commercial production of hemp by removing it from the definition of marijuana under the federal Controlled Substances Act. The Farm Bill authorizes a state desiring primary authority to regulate and monitor hemp production to submit a plan to the U.S. Department of Agriculture (USDA) for approval. (In the absence of a plan, hemp producers will be subject to regulation directly by the USDA.) Based on this authority, Virginia's General Assembly enacted legislation in January 2020 to legalize production of industrial hemp and to establish a framework for regulation of these activities.

Here are the recent regulatory developments pursuant to the Farm Bill and Virginia's legislation:

USDA Interim Final Rule

On October 31, 2019, the USDA issued an interim final rule to create a regulatory plan for review and approval of plans submitted by states and Indian tribes for domestic hemp production.

The USDA's plan includes provisions requiring the state to address:

1. Licensing of hemp producers;
2. Maintaining information on the land on which hemp is produced;
3. Testing for THC levels;
4. Disposing of plants not meeting necessary requirements; and
5. Ensuring compliance with the law.

Joint Statement from Federal Banking Agencies

On December 3, 2019, the federal banking agencies, in consultation with the Conference of State Bank Supervisors, issued the first official statement confirming the ability of banks to serve hemp-related businesses. The statement provides clarity about the legal status of commercial growth and production of hemp and the relevant requirements for banks under the Bank Secrecy Act (BSA).

> **"Once Virginia's hemp production plan is approved, there will be greater certainty about the legal requirements.**

This statement provides that pursuant to the Farm Bill and the USDA's interim final rule, hemp may be grown only with a valid USDA-issued license or under a USDA-approved state or tribal plan. The agencies emphasize marijuana is still a controlled substance and the Farm Bill amended the definition of marijuana only to exclude hemp from the Controlled Substances Act.

With respect to BSA considerations, the statement declares since hemp is no longer a controlled substance under federal law, banks are not required to file a Suspicious Activity Report (SAR) on a customer solely because the customer is engaged in the growth or cultivation of hemp under applicable law.

INSIDE:

Virginia's Plan to Regulate Hemp Production

On January 15, 2020, the Virginia Department of Agriculture and Consumer Services (VDACS) submitted Virginia's Plan to Regulate Hemp Production to the USDA for review and approval. The Virginia plan outlines how VDACS will handle registration of hemp producers, testing for THC levels, disposal of plants, and enforcement. The USDA has 60 days to respond to Virginia's proposed plan.

Legal and Regulatory Considerations

The federal agencies' statements on hemp-related businesses and actions taken by the USDA and VDACS to establish the regulatory framework for Virginia hemp production help banks better understand how they can serve such businesses.

Once Virginia's hemp production plan is approved, there will be greater certainty about the legal requirements for businesses engaged in hemp production in Virginia, and as a result greater certainty for banks seeking to serve them.

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FDIC, OCC Warn of Heightened Cybersecurity Risk

On January 16, the Office of Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) issued an inter-agency statement in response to the heightened risk of cyber-attacks as a result of geopolitical tensions. The statement focuses on risk management principles that can reduce exposure to a cyber-attack and minimize business disruptions.

According to the statement, implementing and maintaining effective cybersecurity controls are critical to protecting against malicious activities. The statement highlights principles previously articulated by the federal banking agencies:

Business Resilience

"Senior management should reevaluate the adequacy of information technology safeguards against threats, especially safeguards against ransom and other destructive malware."

Authentication

"The proliferation of phishing attacks … compromising login credentials warrants financial institutions having appropriate identity and access management controls, including authentication controls, for customer, employee, and third-party access to systems."

System Configuration

"Financial institution management should review the appropriateness of default system settings, change default user profiles, configure security settings, and implement security monitoring tools."

Security Tools

"Employ qualified cybersecurity staff in house, or a qualified managed security service provider firm, to actively monitor systems for network threat and vulnerability information…"

Data Protection

"Maintain a data classification program to identify sensitive and critical data. Encrypt or tokenize sensitive and critical data in transit and at rest."

Employee Training

"Employees are a critical control point for a financial institution's cybersecurity program and that social engineering is a primary tactic that malicious actors use to gain entry to systems."

The FDIC and OCC encourage banks to take this opportunity to reevaluate their digital safeguards under these principles.

Contact the Cybersecurity & Data Privacy or Financial Services team if you have concerns about your bank's cybersecurity risk.

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Source: https://www.fdic.gov/news/news/financial/2020/fil20003a.pdf

Modernizing the CRA: Proposed Changes

On January 9, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation published proposed changes to the Community Reinvestment Act (CRA) regulations in the Federal Register.

Goals of the Proposed Changes

In order to encourage more qualifying CRA activities, the proposal seeks to modernize CRA regulations and make them more objective, transparent, consistent, and easy to understand.

The OCC and FDIC state the proposal would achieve these goals by:

1. **Clarifying** what counts for CRA credit;
2. Updating **where** bank activity counts;
3. **Evaluating** CRA performance more **objectively**; and
4. Making CRA reporting more **transparent and timely.**

Key Provisions in the Proposal

1. **Expanding Qualifying Activities**
   The proposal would require the agencies to publish a non-exhaustive list of qualifying activities and establish a process for banks to seek confirmation beforehand that an activity qualifies for CRA credit.

   The proposal would also expand activities that qualify, including those in areas that have traditionally lacked access to financial services: distressed areas, underserved areas or "banking deserts", and Indian country.

2. **Expanding Where CRA Activity Counts**
   The proposal would preserve the current requirement that banks delineate their assessment areas around their main office, branches, and non-branch deposit-taking facilities for the purpose of measuring CRA performance. However, regulators recognize the impact of online banking and that many banks receive large portions of deposits outside their facilities-based assessment areas. Therefore, banks would be required to delineate additional, non-overlapping "deposit-based" assessment areas where they have significant concentrations of retail domestic deposits.

   In particular, a bank that received 50 percent or more of its retail deposits outside its facilities-based assessment area would be required to describe deposit-based assessment areas where it received 5 percent or more of its retail deposits, based on the physical addresses of its depositors. Such a bank could receive CRA credit for qualifying activities in both the facilities-based assessment area and its deposit-based assessment area.

3. **Performance Standards**
   New general performance standards would measure two fundamental components of a bank's CRA performance.

   The first component will be the number of qualifying retail loans to low-to-moderate income (LMI) individuals, small farms, small businesses, and low-to-moderate income (LMI) areas.

   The second component will be the impact of a bank's qualifying activities, measured by the value of activities relative to its retail domestic deposits.

4. **Small Banks**
   The proposal gives small banks, defined as those with assets of $500 million or less, the option to decide to be evaluated under existing CRA rules or the new regulatory framework.

5. **Home Mortgage Loans**
   Home mortgage loans made to middle- and high-income persons living in LMI areas would no longer receive CRA consideration.

6. **Small Business Loans and Small Farm Loans**
   The proposal raises the eligible size of a loan that qualifies as a small business loan or small farm loan in an LMI from $1 million to $2 million and indexes this ceiling to account for inflation.

7. **Data Collection, Recordkeeping, and Reporting**
   The proposal calls for enhanced requirements for banks to help the agencies measure, assess, and understand CRA activity.

The Federal Reserve

Significantly, the Federal Reserve Board did not join the OCC and FDIC in the proposed rulemaking. Federal Reserve officials have indicated the Federal Reserve is considering its own proposal, although it has said that uniform CRA regulation remains its goal.

The prospect of different CRA regulations for Fed-supervised banks versus OCC- and FDIC-supervised banks is unprecedented.

Comment Deadline

The proposal has a comment deadline of March 9, 2020.

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The bank's critical issue is then determining whether such a business is complying with the hemp provisions in Virginia law and then monitoring the business to ensure ongoing compliance.

A Virginia bank should take the following steps:

1. Review and record a copy of the current VDACS registration;
2. Verify the registrant's good standing through VDACS;
3. Obtain a certificate from the business as to its compliance with the law and require periodic updates about the business's ongoing compliance, particularly with respect to THC level requirements;
4. Develop an understanding of the normal and expected activity for business, and, as appropriate, obtain a list of the business's current suppliers and customers;
5. Require the business to provide testing results for THC levels—hemp contains no more than 0.3% tetrahydrocannabinol;
6. Obtain an indemnification agreement to protect the institution against risks of the business's non-compliance; and
7. Establish a process for ongoing monitoring of the business and its accounts.

The Woods Rogers' Cannabis team—including banking and real estate zoning attorneys—will continue to provide updates on any developments in this area.

GUEST COLUMN:

Virginia Employers, Marijuana, and Employee Rights

"San Francisco hosted the first medical marijuana job fair. The keynote speech was titled, 'Jobs and How to Avoid Getting One.'" –Jay Leno

Leno's joke may be dated, but at least in Virginia, where more than 76,000 people work in the financial sector as of early 2020*, it still rings true. While 11 states and close neighbor the District of Columbia have fully legalized marijuana for recreational use—and the vast majority of states have authorized marijuana for medical use to some degree—Virginia remains an outlier.

Aside from a very narrow exception for limited and rare medical conditions, Virginia's total prohibition on marijuana remains largely in place for now. Virginia employers are generally allowed to require employees and applicants to be free from having a detectable presence of marijuana, which includes being able to pass a drug test.

The status quo is set to change, however, and likely soon. Marijuana decriminalization is a priority of the Governor and General Assembly this year, with Governor Northam pledging "meaningful second chances" for individuals previously incarcerated for marijuana-related crimes. Eighteen states, including Virginia's neighbors Maryland and West Virginia, all place some form of restriction on an employer's right to take adverse action against employees or applicants for their otherwise-lawful use of marijuana. Whether Virginia will adopt a similar policy is unclear, but the trend is evident.

In the meantime, employers in Virginia should avoid automatically screening applicants who have a criminal history for marijuana possession or use, but who otherwise pass appropriately-administered drug tests.

*Source Financial Sector Employment Figures: FDIC/NCUA Quarterly Reports

The Equal Employment Opportunity Commission has long cautioned that an applicant's criminal history should only be considered if it is job-related and consistent with a business necessity. For example, an applicant for a laborer position that is not safety-sensitive should not be automatically disqualified because of a misdemeanor possession charge from years earlier.

> **"Eighteen states place some form of restriction on an employer's right to take adverse action against employees or applicants for their otherwise-lawful use of marijuana.**

Conversely, an applicant for a position that may involve driving or operating equipment who has a more recent marijuana-related conviction may be ineligible. As Cheech famously asked Chong, "*Hey, how am I driving, man?,*" to which Chong replied, "*I think we're parked*."

Keeping track of employment laws that could affect your operations and customer service is paramount. In summary, Virginia has not yet joined the majority of other states in significantly loosening its prohibition on marijuana (which remains illegal federally). However, the status quo is not likely to hold, "*for the times, they are a-changin'*."

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