

KENTUCKY DEPARTMENT OF FINANCIAL INSTITUTIONS
SUPERVISORY GUIDANCE: 2016-1

FROM: Charles A. Vice,
KDFI Commissioner



TO: State-chartered Depository Institutions

DATE: May 1, 2016

RE: Industrial Hemp Production in Kentucky and Bank Secrecy Act (BSA) and
Anti-Money Laundering (AML) Procedures

SUMMARY

This guidance establishes the Kentucky Department of Financial Institutions' (DFI) position regarding a state-chartered depository institution's obligations under the BSA/AML laws relating to government authorized industrial hemp programs. Federal regulation and examination procedures provide little or no clarity to depository institutions regarding BSA/AML requirements relating to customers engaged in the production of industrial hemp.

DFI examiners assess compliance with BSA/AML laws during periodic safety and soundness examinations of state-chartered depository institutions. Because industrial hemp production is currently authorized pursuant to state and federal programs, DFI does not perceive that participation in such an authorized program should serve as the basis for categorizing the customer as high risk for BSA/AML purposes. Furthermore, the DFI does not believe that long-standing customer relationships should be diminished or terminated due solely to a customer's participation in the program. Accordingly, the DFI believes that a depository institution's obligations under the BSA/AML, as it relates to a customer engaged in the lawful production of industrial hemp, are satisfied as long as the depository institution:

- Complies with existing BSA/AML statutes;
- Implements an effective Customer Identification Program (CIP) and due diligence program (which need not include classifying a customer as higher risk due solely to the fact that a customer is engaged in the lawful production of industrial hemp);
- Implements reasonable and effective enhanced due diligence procedures for high risk customers; and
- Reviews and maintains a copy of the authorizing Memorandum of Understanding (MOU) signed between the farmer and the Kentucky Department of Agriculture (KDA), or other official document authorizing the hemp production activity.

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BACKGROUND

Federal BSA/AML laws require all U.S. depository institutions to assist in the detection, prevention, and reporting of money laundering and terrorist financing. Depository institutions are required to develop a written CIP and to take reasonable steps to identify customers and transactions that may pose any known or suspected risk for money laundering or suspicious activity. In implementing these programs, depository institutions should use risk categories and implement enhanced due diligence procedures and monitoring whenever a customer or account is reasonably identified as having characteristics that indicate a higher risk for money laundering or terrorist financing.

The KDA is currently administering an industrial hemp program, based on the following:

- 1) Kentucky Statute: 2013 Kentucky Laws Ch. 134 (SB 50), codified as Kentucky Revised Statutes (KRS) 260.850 to 869, which was enacted by the Kentucky General Assembly in 2013. This legislation established a program for licensure to allow persons to grow industrial hemp in Kentucky in compliance with federal and state law.
- 2) Federal Law: Section 7606 of the Agricultural Act of 2014, which was signed into law on February 7, 2014, and codified as 7 U.S.C. §5940. This legislation allowed state departments of agriculture, in states where the cultivation or growth of industrial hemp is legal, to administer industrial hemp pilot programs in conjunction with universities for the purposes of research and development.

The Kentucky industrial hemp program allows farmers to become agents of the KDA for the purpose of conducting industrial hemp research. In 2015, over three hundred (300) farmers applied for a MOU to grow industrial hemp as agents for the KDA, and 100 MOUs were signed. In 2016, the KDA anticipates approximately 4,500 acres of industrial hemp will be grown as a part of the pilot program. The product can be transported, processed, and sold across state lines, as long as it is grown and cultivated as part of the program. Once a farmer and the KDA sign the MOU, the following occurs:

- The hemp field is designated with GPS coordinates;
- The farmer must provide notice prior to harvest;
- The farmer must provide notice prior to transportation; and
- The farmer must notify state police of the MOU.

RISK MANAGEMENT PROCESS AND EXAMINATION PROCEDURES

Depository institutions should assess and follow their CIP procedures and due diligence standards when opening accounts for all customers, including farmers participating in the KDA industrial hemp program. In collecting data necessary to assess the risks associated with a farmer's participation in the KDA program, state-chartered depository institutions should review and maintain a copy of the MOU executed with the KDA. The DFI believes that categorization as high-risk for BSA/AML purposes is not required due solely to the fact that a farmer is participating in the program, or has applied to participate in the program.

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REFERENCES

Bank Secrecy Act, 31 U.S.C. §5311 to §5314

- The Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act of 1970 (31 U.S.C. 5311 et seq.) is referred to as the Bank Secrecy Act (BSA).
- CIP Guidelines for banks, savings associations, and credit unions can be found at 31 C.F.R. §1020.220. Written CIPs must be appropriate for a financial institution's size and type of business and generally, are part of the institution's anti-money laundering compliance program.
- Due diligence program requirements for covered banks, savings associations, and credit unions can be found at 31 C.F.R. §1010.620. See 31 C.F.R. §1020.620. Due diligence programs must include policies, procedures, and controls for detecting and reporting known or suspected money laundering or suspicious activity.
- Guidance on enhanced due diligence procedures can be found in the Federal Financial Institutions Examination Counsel's Bank Secrecy Act / Anti-Money Laundering Examination Manual. The following are addressed in the manual:
 - Customers that are deemed by a financial institution's due diligence program to pose higher money laundering or terrorist financing risks should be reviewed more closely at account opening and more frequently throughout the term of their relationship with the financial institution.
 - A financial institution may determine that a customer poses a higher risk because of the customer's business activity, ownership structure, anticipated or actual volume and types of transactions, including those transactions involving higher-risk jurisdictions. Financial institutions should consider whether risk profiles should be adjusted or suspicious activity reported when the activity is inconsistent with the profile.

KRS 260.850 to 260.896 establishes:

- An industrial hemp commission to promote the research and development of industrial hemp, and commercial markets for Kentucky industrial hemp and hemp products;
- A five year industrial hemp research program, to be directly managed by the University of Kentucky Agricultural Experiment Station, to conduct research on industrial hemp for a variety purposes;
- An industrial hemp licensing program; and
- Language that "Kentucky shall adopt the federal rules and regulations that are currently enacted regarding industrial hemp and any subsequent changes thereto."

7 U.S.C. §5940 – Section 7606 of the Agricultural Act of 2014 provides:

- A carve out from federal drug laws for industrial hemp research;
- For hemp to be produced if it is grown or cultivated for purposes of research conducted under an "agricultural pilot program"; and
- Each state's department of agriculture to promulgate regulations to carry out the pilot program.