

Hemp Is Now Legal. What Does that Mean for Banking CBD Businesses?

By Heather Archer Eastep

The Agricultural Improvement Act of 2018 legalized hemp, a low-THC, potentially high-CBD variety of cannabis. Prior to the bill, hemp was a federally controlled substance because, like marijuana, it is a form of the cannabis plant. The 2018 Farm Bill removed hemp from the list of controlled substances and reclassified it as an agricultural commodity, so long as its products do not have more than the federally allowed 0.3 percent THC. THC is a psychoactive compound, providing the “high” in marijuana, while CBD is non-psychoactive, but may provide certain health benefits, many of which are still being studied.

However, federal law is just one part of the hemp puzzle. Financial institutions considering banking hemp customers must also understand their state and local laws with respect to hemp and CBD, which will govern the cultivation and handling of hemp and possibly additional laws related to the retail sales of hemp products, such as CBD oil. Generally, state law requires a license to cultivate and process hemp, and certain states and localities have separate laws requiring licenses for retail sales of hemp products.

Uncertainty surrounds banking hemp customers, stemming from the absence

of federal regulations on hemp from the USDA to support the 2018 Farm Bill provisions. Another source of uncertainty is existing FDA regulations, which make food and dietary supplements containing CBD illegal. Although the FDA has held hearings on CBD, it has not indicated if or when its regulations may change. There is also uncertainty due to the evolving position of card networks and processors of payments transactions, which have indirectly expressed concern over the monitoring of hemp activities under a rapidly changing regulatory framework.

Banks that have previously banked marijuana or cannabis customers must assess the risk of violating federal criminal laws, as marijuana remains illegal under federal law, as well as federal money laundering laws because the transactions relate to “specified unlawful activities.” However, those risks are mitigated with respect to hemp by an effective Compliance Management System (CMS) in which a bank “onboards” a hemp or CBD customer consistent with its procedures for higher-risk customers, including:

- » Performing initial diligence on the legality of the customer’s activities, including state licensing,
- » Ongoing monitoring of hemp customers,

Continued on page 5 »

EVENTS

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**2 Four
Employment
Law Issues
to Monitor**

**3 Seller’s Market?
A Guide to Finding
Liquidity Among
Your Holdings**

**4 Bank Call Reports:
Understanding
Signature
Requirements**

**4 Bank Director
Online Training**

**5 FASB Hints at
CECL Delay**

Four Employment Law Issues to Monitor

By Jennifer Nodes and Janet Olawsky

Essential to any risk management plan is staying well-informed of employment law issues facing the workforce. Four areas to watch in the second half of 2019 include the Supreme Court's impending consideration of what "sex" means in the context of sex discrimination, exponentially increasing claims of sex-based harassment and awards to whistleblowers, and an onslaught of wage and hour regulations.

DISCRIMINATION ON THE BASIS OF SEXUAL ORIENTATION AND GENDER IDENTITY

In its upcoming 2019-2020 term, the United States Supreme Court will hear three cases regarding whether Title VII of the Civil Rights Act of 1964 guarantees protections from workplace discrimination to gay and transgender employees. Title VII explicitly prohibits employers from discriminating against employees "because of...sex." However, whether "sex" also includes an individual's gender identity, or his or her sexual orientation, has been inconsistently decided among federal courts across the country. The Supreme Court's decision in those cases—*Altitude Express Inc. v. Zarda*; *Bostock v. Clayton County, Georgia*; and *R.G. & G.R. Harris Funeral Homes v. Equal Employment Opportunity Commission*—will ultimately bind all federal courts.

With the current makeup of the Court (particularly the recent appointments of conservative justices Neil Gorsuch and Brett Kavanaugh), it seems more likely than in years past that the Court will hold that Title VII's reference to "sex" does not prohibit employers from taking adverse action against their employees based on the employees' sexual orientation or gender identity. If the Supreme Court rules that way, no federal law will prohibit employers from terminating, demoting, refusing to hire, or taking other similar actions against an employee because he or she is gay or transgender. Additionally, because only 21 states and the District of Columbia have local laws prohibiting discrimination on the basis of sexual orientation or gender identity, workers in the remaining states will be left without recourse if they are terminated for those reasons.

Anticipating this possible outcome, last month the United States House of Representatives passed the Equality Act which would expand Title VII protections. The Republican-majority Senate has

yet to weigh in. With such wide-ranging impact, this will be an important issue to watch.

SEX HARASSMENT

Although the definition of "sex" may be in flux, Title VII isn't ambiguous in its prohibition against sex-based harassment. The number of these claims continue to rise, proving the #MeToo movement is still a force in the workplace that cannot be ignored. The Equal Employment Opportunity Commission's (EEOC) 2018 Financial Year-End Report noted that sexual harassment charges increased over 13 percent from the year before. The EEOC recovered over \$56 million for employee victims of sexual harassment. This figure is remarkable in itself, but even more extraordinary when considering it does not take into account the results of private litigation. The number of reports of sex-based harassment against employers, and the amount of recoveries, are expected to continue throughout 2019.

WHISTLEBLOWERS

The number of whistleblower complaints is also rising. In the last year, over 50 percent of EEOC charges included an allegation that the employee suffered some type of retaliation from his or her employer. This rise represents a 20 percent increase. Even more notable, jury and agency awards is dramatically increasing. The SEC's awards to whistleblowers in 2018 and 2019 are higher than ever: its four largest whistleblower awards have come in the past two years, paying out whistleblowers between \$33 and \$50 million.

LEAVE LAWS

Finally, states and municipalities across the country are continuing to pass leave laws that entitle employees to time away from work in the event of illness or the illness of their family members. California, Massachusetts, New Jersey, and Michigan have all recently passed or expanded leave laws. Cities are also joining the trend (as one example, St. Paul, Minneapolis, and Duluth, Minnesota each enacted unique sick and safe time ordinances), resulting in a patchwork of inconsistent regulations for employers to digest and ensure compliance.

By Jennifer Nodes, Principal and Janet Olawsky, Associate, Jackson Lewis P.C.

Seller's Market?

A Guide to Finding Liquidity Among Your Holdings

By Jim Reber

Quick: What are the most saleable assets on your community bank's balance sheet? If you get this wrong, you need to be running a "not-for-profit depository financial institution."

Bonds, of course. Most people I talk to consider the liquidity feature a close second (to safety) in importance when contemplating a purchase. That feature has come into play for thousands of community banks in the last several years, as loan demand has outstripped deposit growth. Between December 2013 and December 2018, investments as a percent of assets dropped from 23 to 18 percent for the community bank industry as a whole. While most of the decline was simply maturing bond proceeds being reallocated into loans, some portion was outright securities sales to fund new credits.

ASSIST: FEDERAL RESERVE

You may also have noticed that your bonds' prices have risen in 2019. Since rates peaked last November, there has been a strong market rally across the entire yield curve, particularly beyond two years. For example, if you had purchased the new five-year Treasury note last November, you would now have a nearly five-point gain in that bond. Yields in that sector are down around 125 basis points in about seven months.

That has essentially wiped out unrealized losses in community banks' bond portfolios. As of the end of June, the average portfolio was worth slightly more than the collective book prices of the bonds. What that means in practice is that you probably own some bonds at higher prices than they're currently worth, and others at lower prices. And this is exactly what you should hope for.

If a community bank owns some winners and some losers, and it decides it needs to sell, it can manage the impact on current year earnings very easily. As 2019 progresses, it's clear that industry earnings will be quite good, so it is entirely possible that a bank may choose to realize some losses on sales of bonds now and push that income (and tax liability) into future years.

PRICED TO SELL

Assuming for the moment that a community bank is ambivalent about booking any gains or losses and is instead more focused on the creation of a liquidity pad, there is a basic rule of portfolio management that needs to be applied to achieve maximum benefit. This is the concept of the "take-out yield." Take-out yield has several other nicknames like market yield or give-up yield, and what it quantifies is the yield that a purchaser of your bond would get, if you were to sell that bond today.

The lower the take-out yield, the more efficiently you have sold your bond. Economically, the seller will have to re-employ the proceeds at a return higher than the take-out yield for the sale/reinvestment to make sense. So, a wise portfolio manager will resist the temptation to cash in gains, unless the sale item results in a low take-out yield. Your broker should readily identify the take-out yield on any security that you're thinking about selling at the same time you receive a bid.

KEEP THESE IN MIND

There are a couple of other variables that could impact if, or what, your community bank might sell. One is that you likely can't sell a bond that was designated Held to Maturity on purchase

Continued on page 6 >>



Interactive Portfolio Site

ICBA Securities' clearing broker Vining Sparks has an interactive website with portfolio management tools. Included is a private portal which can help identify securities that may be attractive sale candidates. For access to the website, contact your Vining Sparks sales rep or visit www.viningsparks.com.

Bank Call Reports: Understanding Signature Requirements

Amanda Garnett

Even though call reports are filed electronically, there are still requirements that management and board members sign the coversheet of the call report and maintain those signatures in their files. The call report must be signed by the chief financial officer (CFO) of the bank or the institution's equivalent.

Call reports of national banks, state member banks, and savings associations are required to be signed by at least **three board members** in addition to the CFO. Call reports of state nonmember banks are required to be signed by at least **two board members** in addition to the CFO.

ATTESTATION REQUIREMENTS

By signing the coversheet of the call report, these individuals are attesting to its accuracy.

CFOs attest that the call report has, "been prepared in conformance with the instructions issued by the appropriate federal regulatory authority and are true and correct to the best of my knowledge and belief."

Board members attest that the call report has, "been examined by us and to the best of our knowledge and belief have been prepared in conformance with the instructions issued by the appropriate federal regulatory authority and are true and correct."

These are high standards. And as I speak to call report preparers across the country, I have found that frequently board members spend very little, if any, time reviewing the information included in the call report that they sign.

There are consequences for banks and the signers. CFOs and individual board members have been cited during examinations and in formal regulatory agreements for filing



Continued on page 6 >>

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- » Regulation CC: Funds Availability Act—Overview
- » Ethics for Bankers
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- » IT Security for Banks
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- » Regulatory Examination Preparation
- » Regulation O: Insider Lending Overview
- » Regulation Z: Overview
- » Regulation E: Electronic Funds for Bank Directors
- » Bank Secrecy Act—Sr. Management & Bank Directors
- » Understanding UDAAP

» Continued from page 1

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- » Developing customer-specific risk tolerances for both credit and deposit hemp customers, and
- » Obtaining contractual covenants and obligations from hemp customers.

Banks entering into this space should build out a CMS with hemp-specific policies and procedures designed to ensure that the customers are operating within the bank's established risk parameters and operating under applicable law. Banks 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 customer is determined not to be operating in compliance with federal or state law, in which case the bank may need to implement measures with respect to the customer, potentially including the filing of a suspicious activity report.

Additional points to consider as banks work through banking hemp or CBD customers:

- » 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? And have the customer's hemp industry counterparties obtained all necessary licenses?
- » Does the bank have sufficient collateral if lending to hemp or CBD customers, given that the product may have to be destroyed or subject to forfeiture and seizure (along with other assets of the borrower) if the THC content exceeds 0.3 percent?
- » Will the bank be processing payments for hemp or CBD customers, potentially implicating card network rules?
- » Does the bank have flexibility to alter its arrangements with a customer as federal and state regulations are issued with respect to hemp and CBD?
- » Did the bank obtain board of director approval of hemp banking activity generally and develop board reporting specific to hemp consistent with its existing management information system?

Navigating the hemp landscape can be accomplished through effective risk management. We have helped banks implement compliance management systems for higher-risk customer that have been passed upon in bank regulatory examinations. Doing so, however, will require adjustments and tailoring within a bank's CMS prior to commencing the activity to effectively manage the risk.

By Heather Archer Eastep, Partner, Hunton Andrews Kurth, LLP

FASB Hints at CECL Delay

By Neil Falken

In a recent American Banker interview, Financial Accounting Standards Board Chairman Russ Golden defended the new accounting standard but also hinted at a possible delay in the implementation for smaller financial institutions and community banks. The article also mentions additional resources and guidance to assist these institutions with better information and guidance which is meant to alleviate some CECL fears.

As always, there is no guarantee this delay will occur but we at CliftonLarsonAllen wanted to bring it to your attention that the possibility is out there. FASB is expected to continue these discussions at upcoming meetings.

By Neil Falken, Principal, CliftonLarsonAllen (CLA)



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» Continued from page 3

Seller's Market? A Guide to Finding Liquidity Among Your Holdings

date. That alone is a good reason to classify 100 percent of your bonds as Available for Sale.

Another widely under-reported fact of the bond market is that liquidity will dry up as we approach a quarter- or year-end. How much this affects prices is difficult to quantify, but I would recommend not bidding anything within two weeks of the end of a reporting period.

Also, you likely have other liquid assets on your balance sheet, besides your investments. There is a robust secondary market for most performing loans, beyond conforming residential mortgages. Government-guaranteed sectors such as SBA 7(a) and USDA loans can be efficiently sold. And even non-guaranteed loans can fetch attractive prices, especially in the current yield environment.

A final thought: usually, yield spreads widen as interest rates fall. They have not yet widened out noticeably from the peak in rates late last year, at least on many sectors that are popular with community banks. This includes callable agencies, munis and straight pass-through mortgage-backed securities. All of which makes the mid-2019 bond market an attractive time to consider targeted sales.

By Jim Reber, President and CEO, ICBA Securities

» Continued from page 4

Bank Call Reports: Understanding Signature Requirements

inaccurate reports and criticized for failure to identify errors or inconsistencies. CAMELS ratings can suffer, and regulatory action can be taken.

MITIGATING THE RISK

To ensure that call reports are being adequately reviewed prior to filing, banks can:

- » Ensure call report preparers are adequately trained,
- » Ensure that the call report is reviewed in detail by someone independent of the preparation process to help identify any errors or inconsistencies,
- » Ensure that the call report is prepared well in advance of the deadline and provided to the CFO and board members in plenty of time for them to review the document prior to filing, and
- » Perform periodic training for board members on important call report issues such as regulatory capital to ensure they understand the reports they are signing.

Banks may also consider periodically engaging a third party to perform an internal audit of the call report schedules and internal controls over call report preparation.

Amanda Garnett, Principal, CliftonLarsonAllen (CLA)



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