

## **Banking Operations & FinTech Update**

**April 2018**

### **NINTH CIRCUIT: FFIEC BSA/AML EXAM PROCEDURES LEGAL AUTHORITY FOR BSA REGS**

The Ninth Circuit Court of Appeals recently held that the FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual (FFIEC Manual) is controlling legal authority in interpreting the Bank Secrecy Act (BSA) regulations. *Cal. Pac. Bank v. FDIC*, 2018 U.S. App. LEXIS 6047 (9th Cir. Mar. 12, 2018).

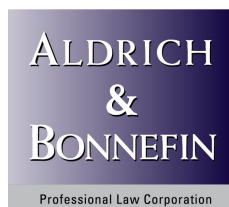
The FDIC initially conducted a BSA exam of California Pacific Bank in 2010. While the FDIC found that the bank's BSA program was satisfactory, it noted that there were several areas requiring correction. The corrective action requirements included, among other things: (i) director training as well as testing of employees' BSA knowledge; (ii) designating new customers that have high levels of activity as high risk for at least six months; (iii) monitoring and analyzing aggregate activity for at least three months to establish a pattern of activity; and (iv) increasing the risk rating of the bank's customer base.

When it examined the bank in 2012, the FDIC found that the bank failed to correct the deficiencies and, as such, failed to administer a BSA program that met the BSA's four pillars of compliance: (1) system

of internal controls; (2) independent testing; (3) appointment of a qualified compliance officer; and (4) training for appropriate personnel. Some noteworthy weaknesses the FDIC cited include:

- Downgrading of new customer risk profiles despite high levels of account activity and failure to monitor high-risk accounts on a long-term basis;
- Enlisting an auditor for independent testing who was a bank consultant and assisted in drafting the bank's BSA policy manual, suggesting a conflict of interest;
- Appointing a BSA compliance officer who lacked the necessary BSA experience; and
- Inadequate training, including not tailoring training to specific employee roles.

Accordingly, the FDIC issued a consent order against the bank for these BSA deficiencies. The bank refused to agree to the consent order, prompting the FDIC to impose a cease and desist order against the bank. After an administrative law judge and the FDIC affirmed the cease and desist order, the bank filed a petition for the Ninth Circuit Court of Appeals' review. The bank argued, among other things, that the BSA is unconstitutionally vague, and that the FDIC's reliance on the FFIEC Manual to identify these violations was improper because the manual



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lacks the force and effect of law. The Ninth Circuit denied the petition and, in so doing, held that the FDIC properly used the FFIEC Manual to determine whether the bank violated BSA's four pillars. As the Ninth Circuit put it, the BSA regulations' ambiguities warrant deference to the drafting agency's interpretations, so long as the interpretations are not "plainly erroneous or inconsistent" with the regulation's wording. Therefore, the court maintained that the FDIC acted in accordance with the law in referencing the FFIEC Manual to clarify the four pillars analysis for determining BSA violations.

This ruling emphasizes what most financial institutions already know: adherence to the FFIEC Manual's directives is imperative to implementing an adequate BSA/AML compliance program.