
NYDFS Issues Final Rule Requiring Certification of Compliance With AML Transaction Monitoring and Filtering Program Requirements

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The New York Department of Financial Services (NYDFS) recently finalized a [regulation](#) that mandates detailed elements of the anti-money laundering (AML) transaction monitoring and sanctions filtering programs of covered institutions. The rule, published on June 30, 2016 (NYDFS Rule), also requires directors or senior officers to certify their institutions' compliance with these new standards.

The NYDFS Rule creates detailed state-level obligations for AML and sanctions compliance, areas that have traditionally been left to federal oversight. In some respects, the new rule goes beyond federal law, which has never codified the particulars of an AML transaction monitoring or sanctions filtering program in such detail.

NYDFS had issued its proposed rule on December 1, 2015, and in response to industry comments, it revised several aspects of the NYDFS Rule. For example, the NYDFS Rule permits slightly more flexibility in implementing the specific transaction monitoring and filtering requirements and allows officers other than the chief compliance officer (CCO) to sign the compliance certification. However, the basic programmatic and individual certification requirements remain the same. NYDFS has said that these requirements are necessary due to “shortcomings” it identified in these programs that are attributable to “a lack of robust governance, oversight, and accountability at senior levels.”

Although the NYDFS Rule nominally only applies to New York-regulated banks, check cashers, and money transmitters (Regulated Institutions),¹ it could more broadly affect the branches and affiliates of Regulated Institutions because large institutions use enterprise-wide transaction and monitoring systems.

The NYDFS Rule takes effect January 1, 2017, and the initial certification is due to NYDFS on April 15, 2018. Regulated Institutions thus have less than six months to put in place any programmatic changes necessary to achieve compliance.

Below we outline the requirements of the NYDFS Rule, highlight changes from the proposed rule,

and note key implications for Regulated Institutions.

Transaction Monitoring Program. Regulated Institutions are required to maintain a “reasonably designed” transaction monitoring program (either manual or automated) to monitor for potential violations of the Bank Secrecy Act (BSA) and to comply with their Suspicious Activity Reporting (SAR) obligations. A reasonably designed program should be based on the institution's risk assessment and include the following attributes, “to the extent they are applicable”:

- be reviewed at risk-based intervals and periodically updated to reflect changes to applicable laws, regulations and regulatory warnings, as well as any other information determined by the institution to be relevant;
- match BSA/AML risks to the institution's businesses, products, services, customers, and counterparties;
- use threshold values and amounts designed to detect potential money laundering or other suspicious or illegal activities;
- be subject to end-to-end testing, both before and after implementation;
- documentation articulating the detection scenarios and the underlying assumptions, parameters, and thresholds;
- protocols regarding the investigation alerts, the process for deciding which alerts will result in a filing or other action, the operating areas and individuals responsible for making such a decision, and how the investigative and decision-making process will be documented; and
- be subject to an ongoing analysis to assess the detection scenarios, the underlying rules, threshold values, parameters, and assumptions.

The NYDFS Rule reflects some concessions to industry comments on NYDFS' proposed rule. The transaction monitoring attributes are no longer strict requirements; they are required only “to the extent they are applicable” as part of a program “reasonably designed” to detect and report suspicious activity. Also, the proposed rule would have required transaction monitoring programs to “reflect all current BSA/AML laws, regulations and alerts, as well as any relevant information available from the institution's related programs and initiatives.” By contrast, the NYDFS Rule provides flexibility for Regulated Institutions to periodically (rather than instantly) update their programs in response to changes to applicable laws and regulations.

Filtering Program. Regulated Institutions are required to maintain a manual or automatic filtering program “reasonably designed” to interdict transactions prohibited by the US Treasury's Office of Foreign Assets Control (OFAC) sanctions programs. Like the transaction monitoring requirements, the filtering program attributes are to be based on a risk assessment and should be implemented to the extent applicable. The program should:

- be based on technology, processes, and tools for matching names and accounts according to the institution's particular risks, transaction, and product profiles;
- be subject to end-to-end testing, both before and after implementation;
- include ongoing analysis to assess the technology and tools for matching names and accounts in light of the risks of the institution; and

- include documentation that articulates the intent and design of the Filtering Program tools, processes, or technology.

In response to industry comments, the NYDFS Rule substitutes a reasonableness standard for what appeared to be strict liability under the proposed rule. It also focuses solely on OFAC and removes broader references to “watch lists” and politically exposed persons. In addition, the proposed rule would have required technology for matching names and accounts to be “adequate to capture prohibited transactions,” while the NYDFS Rule requires only that the technology be “reasonably designed to identify” such transactions.

Attributes of Both Programs. A separate provision in the NYDFS Rule lists required attributes common to the transaction monitoring and filtering programs, again to the extent they are applicable. They include:

- identification of all data sources that contain relevant data and validation of data flows;
- data extraction and loading processes to ensure proper transfer of data to any automated monitoring or filtering system;
- governance, management oversight, and change management processes;
- a vendor selection process if third parties are used;
- adequate funding;
- qualified personnel or third parties for designing, implementing, operating, testing, and analyzing the programs; and
- periodic training of all stakeholders.

Program Changes. To the extent that a Regulated Institution identifies areas for “material improvement,” the institution must document any remedial efforts planned and underway and make such documentation available for inspection by the superintendent of NYDFS. The proposed rule would have prohibited institutions from modifying their transaction monitoring and filtering programs “to avoid or minimize” SAR filings based on alert volume or resource concerns, which would have prevented institutions from adjusting their systems in response to high numbers of false positives. Unlike the proposed rule, the NYDFS Rule provides Regulated Institutions some flexibility to update their transaction monitoring and filtering programs.

Certification Requirement. Regulated Institutions will be required to adopt either an annual board resolution, signed by each director, or a senior officer “compliance finding” to certify compliance with the NYDFS Rule. The requirement reflects a continuing trend by NYDFS and federal regulators towards holding executives accountable for an institution's perceived AML and sanctions program failures.

The resolution or finding must certify that:

- the board or senior officer(s) has reviewed the relevant documents, reports, certifications, and opinions of such officers, employees, representatives, outside vendors, and other individuals and entities as necessary to adopt the Board Resolution or Senior Officer Compliance Finding;

- the board or senior officer(s) has taken “all steps necessary” to confirm that their institution's transaction monitoring and filtering program complies with the transaction monitoring and filtering requirements of NYDFS Rule; and
- the institution's program is in compliance, “to the best of [signer's] knowledge,” as of the date of the Board Resolution or Senior Officer Compliance Finding.

The proposed rule allowed only a CCO (or equivalent) to certify compliance, while the NYDFS Rule lets “senior officer(s)” or a board of directors meet this requirement. But it is not clear whether the change will have a practical effect. The NYDFS Rule defines “Senior Officer(s)” as “the senior individual or individuals responsible for the management, operations, compliance and/or risk of a Regulated Institution.” This definition may be an acknowledgement that some CCOs may not have sufficient authority or broad enough perspective within their organizations to certify compliance with all required elements of the transaction monitoring and filtering programs. However, the NYDFS Rule does not clarify whether a single person with responsibility over just one of these areas (e.g., an operations officer) can satisfy the certification requirement, or whether multiple signers may be required to cover all of these areas.

Regulated Institutions must submit a compliance finding or board resolution on April 15 of each year, regardless of whether the institution is facing compliance challenges with its transaction monitoring and sanctions filtering programs. The NYDFS Rule does not describe what institutions should do when they are aware of material deficiencies in their programs that would prevent individuals from certifying complete compliance by the annual deadline.

Penalties. Although the NYDFS Rule removes an express reference to criminal penalties, it states that it will be enforced pursuant to NYDFS' “authority under any applicable laws.” NYDFS retains the authority to impose civil monetary and equitable sanctions and to refer matters to the New York attorney general for additional civil or criminal enforcement.²

Implications for Regulated Institutions. The NYDFS Rule's detailed programmatic requirements differ from the approach of federal AML and sanctions regulations, which lack the specificity of the NYDFS regulation. Federal law requires financial institutions to implement risk-based AML programs but does not detail the programmatic elements of a transaction monitoring system. As a technical matter, OFAC rules do not require any specific filtering program, though regulatory guidance sets forth minimal expectations for sanctions programs and recommends a risk-based approach.³ While the NYDFS Rule requires transaction monitoring and filtering programs to be “risk-based,” Regulated Institutions may face difficulty explaining to NYDFS a decision not to implement any one of the rule's specific transaction monitoring or filtering attributes.

Banks covered by the NYDFS Rule may face compliance resource challenges to adapt to both this rule and FinCEN's [new regulations on beneficial ownership and customer due diligence](#) released earlier this year. Compliance with the new FinCEN rules is required by May 2018, just one month after the first certification is due on the NYDFS Rule. Both rules will require institutions' prompt assessment of their existing AML systems so that there is sufficient time to implement and validate system changes necessary to comply with each rule.

¹ The NYDFS Rule applies to “Bank Regulated Institutions,” defined as “all banks, trust companies, private bankers, savings banks, and savings and loan associations chartered pursuant to the New York Banking Law (the ‘Banking Law’) and all branches and agencies of foreign banking corporations licensed pursuant to the Banking Law to conduct banking operations in New York.” It also applies to “Nonbank Regulated Institutions,” defined as “all check cashers and money transmitters licensed pursuant to the Banking Law.” The NYDFS Rule does not cover federally chartered depository institutions; persons subject to NYDFS’ new “BitLicense” digital currency regulations, which have separate AML requirements; broker-dealers, which are subject to the BSA and FINRA Rules such as Rule 3310; casinos, which are subject to the BSA; or insurance companies, which are also regulated by NYDFS and in some cases are subject to federal AML rules.

² N.Y. Fin. Serv. Law § 301(c)(4) (giving NYDFS the authority to refer matters to the New York Attorney General); N.Y. Banking Law § 672 (prohibiting the falsification of books, reports, or statements of banks).

³ FFIEC, *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (2014), at 145. The NYDFS Rule’s impact may be greater on New York money transmitters and check cashers, which are not covered by federal bank regulatory guidance and thus are not subject to prudential regulatory expectations that they maintain an OFAC compliance program.

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