

## The New York Department of Financial Services Finalizes Regulation "Clarifying" Transaction Monitoring and Filtering Program Requirements

On June 30, 2016, the New York Department of Financial Services (the "**DFS**") issued a final anti-money laundering ("**AML**") and counter-terrorist financing ("**CTF**") transaction monitoring and filtering programs regulation (the "**Regulation**"). While the final Regulation includes several amendments to the initial proposed regulation issued by the DFS on December 1, 2015 (the "**Proposed Regulation**"), the main substance of the proposed requirements has not changed. The Regulation, which goes into effect January 1, 2017, both codifies heightened standards for transaction monitoring and filtering and imposes an annual compliance certification requirement on either the Board of Directors or Senior Officer(s).<sup>1</sup> DFS-regulated institutions should promptly take steps to ensure that they are prepared to meet the new heightened standards prior to their effective date.

### Application of the Regulation

The Regulation applies to all DFS-regulated institutions, including banks, trust companies, and all branches and agencies of foreign banks licensed by the DFS, as well as money transmitters and cash checkers licensed by the DFS pursuant to the New York Banking Law. The Transaction Monitoring and Filtering Program requirements, as well as the Board of Directors or Senior Officer(s) certification requirement, apply only to the New York offices of non-US banks, rather than the non-US banks themselves.

### Transaction Monitoring Program

Transaction monitoring has been a long standing supervisory expectation in connection with BSA/AML/Suspicious Activity Reporting obligations of financial institutions, which is addressed in the BSA/AML Examination Manual published by the Federal Financial Institutions Examination Council (the "**FFIEC AML Examination Manual**"). Regulations recently finalized by the Financial Crimes Enforcement Network ("**FinCEN**") addressing customer due

---

<sup>1</sup> The first annual certification required under the Regulation will be due by April 15, 2018.

diligence requirements for financial institutions<sup>2</sup> also expressly impose an ongoing transaction monitoring requirement for purposes of Suspicious Activity Reporting.

The Regulation codifies supervisory expectations for transaction monitoring set out in the FFIEC AML Examination Manual and, in some respects, imposes additional technical requirements not specifically addressed in federal regulations or written federal regulatory guidance. In this regard, the Regulation requires DFS-regulated institutions to establish and maintain a Transaction Monitoring Program reasonably designed for the purpose of monitoring transactions after their execution for potential Bank Secrecy Act ("**BSA**") violations and Suspicious Activity Reporting that shall contain specified attributes "to the extent they are applicable." The Transaction Monitoring Program must be "reasonably designed" to monitor transactions and, "to the extent applicable": (i) be based on a related risk assessment conducted by the institution; (ii) be updated periodically on a risk-based intervals to reflect changes in applicable laws, regulations and other relevant information; (iii) appropriately match BSA/AML risks to the institution; (iv) incorporate BSA/AML detection scenarios with appropriately-set threshold values; (v) provide for the maintenance of documentation articulating the detection scenarios, underlying assumptions, parameters, and thresholds; (vi) include protocols setting forth how alerts are generated, processed, and documented; and (vii) include "end-to-end, pre- and post-implementation testing and ongoing analysis of the detection scenarios, the underlying rules, threshold values, parameters, and assumptions."

## Filtering Program

Transaction filtering for sanctions compliance purposes currently is not expressly required by Federal regulation, although it is clearly a safety and soundness supervisory expectation and a standard industry practice. The FFIEC AML Examination Manual states, for example, that "[w]hile not required by specific regulation, but as a matter of sound banking practice and in order to mitigate the risk of noncompliance with OFAC requirements, banks should establish and maintain an effective, written OFAC compliance program that is commensurate with their OFAC risk profile (based on products, services, customers, and geographic locations)." The Regulation expressly requires the implementation of a Filtering Program, which may be manual or automated, that is reasonably designed for the purpose of interdicting transactions that are prohibited by OFAC regulations. The Regulation requires that the Filtering Program include, among other things: (i) end-to-end, pre- and post-implementation testing of the Filtering Program, including, as relevant, a review of data matching, an evaluation of whether the OFAC sanctions list and threshold settings map to the risks of the institution, the logic of matching technology or tools, model validation, and data input and Program output; (ii) ongoing analysis to assess the logic and performance of the technology or tools for matching names and accounts, as well as the OFAC sanctions list and the threshold settings to see if they continue to map to the risks of the institution; and (iii) documentation that articulates the intent and design of the Filtering Program tools, processes, or technology.

---

<sup>2</sup> See [Customer Due Diligence Requirements for Financial Institutions](#), 81 Fed. Reg. 29398 (May 11, 2016).

## Common Required Attributes for the Transaction Monitoring Program and the Filtering Program

The Regulation also provides further requirements or "attributes" that are not expressly covered under existing regulations or written regulatory guidance. Specifically, the Regulation provides that, "to the extent applicable," each Transaction Monitoring and Filtering program shall include:

- identification of all data sources that contain relevant data;
- validation of the integrity, accuracy and quality of data to ensure that accurate and complete data flows through the Transaction Monitoring and Filtering Program;
- data extraction and loading processes to ensure a complete and accurate transfer of data from its source to automated monitoring and filtering systems, if automated systems are used;
- governance and management oversight, including policies and procedures governing changes to the Transaction Monitoring and Filtering Program to ensure that changes are defined, managed, controlled, reported, and audited;
- vendor selection process if a third party vendor is used to acquire, install, implement, or test the Transaction Monitoring and Filtering Program or any aspect of it;
- funding to design, implement, and maintain a Transaction Monitoring and Filtering Program that complies with the requirements of this Part;
- qualified personnel or outside consultant(s) responsible for the design, planning, implementation, operation, testing, validation, and ongoing analysis of the Transaction Monitoring and Filtering Program, including automated systems if applicable, as well as case management, review, and decision-making with respect to generated alerts and potential filings; and
- periodic training of all stakeholders with respect to the Transaction Monitoring and Filtering Program.

The DFS has observed in the course of its examination activities, and is particularly concerned about, changes or alterations to Transaction Monitoring and Filtering Programs for purposes of minimizing generated alerts or avoiding AML/CFT compliance obligations because of insufficient staffing or other resources. The Proposed Regulation contained an explicit statement prohibiting such changes and alterations to Transaction Monitoring and Filtering Programs. The final Regulation removed this statement, but provides that institutions should maintain document updates or redesign of the relevant areas, systems, or processes, and that such documentation must be available for inspection by the DFS.

## Annual Board or Senior Officer Certification Requirement

The Proposed Regulation provided that a "Certifying Senior Officer" must submit to the DFS a duly executed annual "Certification" essentially certifying that the institution's Transaction Monitoring and Filtering Program "complies with all requirements" of the Regulation. The Proposed Regulation also stated that a Certifying Senior Officer who files an incorrect or false certification may be subject to criminal penalties.

The final Regulation replaced the word "Certification" with "Board Resolution" or "Compliance Finding." This semantic distinction appears to be of little significance. The Regulation requires that the Annual Board Resolution or Senior Officer(s) Compliance Finding state: ". . . the Board of Directors or Senior Officer certifies: . . ." (emphasis added). The Final Regulation, however, did add that the certification to be provided is: "to the best of the [Board of Directors] or [Senior Officer(s)] knowledge" based on review of "documents, reports, certifications and opinions of such officers, employees, representatives, outside vendors and other individuals or entities as necessary."

Also, under the Proposed Regulation, the certification would have been provided by the institution's chief compliance officer ("**CCO**") or their functional equivalent (based on the definition of the term "Certifying Senior Officer"). The final Regulation expanded the definition of the term "Senior Officer" to include any "senior individual or individuals responsible for the management, operations, compliance and/or risk." Thus, the certifying Senior Officer under the final Regulation could be, but does not need to be, the CCO. The Regulation also provides that the Board of Directors could adopt a Board Resolution to make the certification required under the Regulation. In practice, we anticipate that the Senior Officer making the required "Compliance Finding" would often be the CCO, potentially acting together with the chief operating officer and/or the chief executive officer of the institution (or office manager in the case of New York banking offices of foreign banks).

As noted above, the Proposed Regulation had included an express reference to the potential individual criminal liability for making a false certification. The final Regulation no longer includes that reference, but of course the potential liability remains nonetheless. The final Regulation does state that it "will be enforced pursuant to, and is not intended to limit, the Superintendent's authority under any applicable laws." DFS has demonstrated a strong commitment to identifying and holding accountable individuals that they deem to be responsible for institutional shortcomings. We expect that DFS will consider the accuracy of the annual Board Resolution or Compliance Finding in connection with any significant Transaction Monitoring or Filtering Program deficiency identified.

## Conclusion

In sum, the Regulation imposes Transaction Monitoring and Filtering Program requirements that go beyond existing Federal regulatory requirements and written supervisory guidance. These requirements place a heavy emphasis on technology, systems, controls and record-keeping. The Regulation also imposes a higher burden on DFS-regulated institutions in that they will have to document and prove how they have complied with the new requirements. Failure to do so could trigger an enforcement action irrespective of any failure to identify prohibited transactions or suspicious activity.

As it codifies DFS's supervisory expectations, the Regulation will make it easier for the DFS to bring enforcement actions against institutions that fall short of these expectations. This is particularly ominous in light of the certification requirement embedded in the Regulation and the very aggressive enforcement stance of the DFS, which has been exhibited in a long line of enforcement actions and severe civil money penalties assessed by the DFS over the last several years. The Regulation will be effective as of January 1, 2017, and DFS-regulated institutions should promptly take steps to ensure they are in compliance with its requirements and have implemented adequate governance and controls designed to ensure the ability for either the Board or the Senior Certifying Officer(s) to make the required annual certification.

## Authors

**David DiBari**

Partner, Washington  
T: +1 202 912 5098  
E: david.dibari  
@cliffordchance.com

**George Kleinfeld**

Partner, Washington  
T: +1 202 912 5126  
E: george.kleinfeld  
@cliffordchance.com

**Megan Gordon**

Partner, Washington  
T: +1 202 912 5021  
E: megan.gordon  
@cliffordchance.com

**Philip Angeloff**

Counsel, Washington  
T: +1 202 912 5111  
E: philip.angeloff  
@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

[www.cliffordchance.com](http://www.cliffordchance.com)

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

© Clifford Chance 2016  
Clifford Chance US LLP

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta\* ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

\*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.