

# Client Update NYDFS Issues Final Anti-Money Laundering and Sanctions Rule

## *Clarifies Program Requirements, Softens Liability for Compliance Officers*

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On June 30, 2016, the New York Department of Financial Services (“NYDFS”) published a final rule requiring certain New York-chartered and regulated institutions (“covered institutions”) to enhance certain elements of their Bank Secrecy Act /anti-money laundering (“BSA/AML”) compliance programs (the “Final Rule”). This rulemaking, which has been highly controversial, has been closely watched.<sup>1</sup>

In the Final Rule, and in response to industry comments (including comments submitted by Debevoise & Plimpton on behalf of our clients), the NYDFS softened several of the most problematic elements of its original proposal (“Proposed Rule”). Significantly, the NYDFS:

- Removed the requirement that a covered institution’s chief compliance officer file an annual compliance certification, requiring instead either a board resolution or “compliance finding” by a senior officer with relevant responsibility. NYDFS also dropped perhaps the most controversial component of the Proposed Rule—the threat of criminal penalties for filing an “incorrect or false” certification.
- Clarified its expectations for the mandatory Transaction Monitoring and Filtering Programs, which now track more closely industry norms and practices.

<sup>1</sup> These rules were proposed on December 1, 2015. For a client update on the Proposed Rule, see “NYDFS Proposes New Anti-Money Laundering Requirements, Liability for Compliance Officers” (Dec. 7, 2015), available [here](#).

The Final Rule continues to contain detailed provisions relating to transaction monitoring and sanctions screening, including elements related to data integrity, governance and oversight. It remains to be seen what the NYDFS' supervisory expectations will be with respect to these elements of the regulation. The Final Rule goes into effect on January 1, 2017.

Below we outline the Final Rule's key requirements, describe its likely implications for covered institutions and describe some of the open questions and potential compliance challenges the Final Rule may pose. We also include, in an appendix, a redline of the Final Rule against the earlier proposal.

## KEY COMPONENTS OF THE FINAL RULE

### Who Is Covered?

The Final Rule applies to bank and nonbank institutions regulated by the NYDFS. This includes entities that are chartered or licensed under the New York Banking Law, such as depository institutions, branches and agencies of foreign banks, trust companies, savings banks, savings and loan associations, check cashers and money transmitters ("covered institutions").

### When Does the Final Rule Take Effect?

The Final Rule becomes effective January 1, 2017. Covered institutions must file their first certification or "compliance finding," as described below, to the NYDFS by April 15, 2018.

### What Must Covered Institutions Do to Comply?

Under the Final Rule, a covered institution must maintain both:

- A **Transaction Monitoring Program** reasonably designed to monitor transactions, after their execution, for potential BSA/AML violations and suspicious activity. Based on the institution's risk profile and risk assessment, such a program should include: appropriate detection scenarios to identify potential money laundering or other suspicious or illegal activities; include the enumerated testing requirements (some of which, as described below, remain vague); protocols for investigating potential hits; and procedures for periodic review and updates at risk-based internals.
- A **Filtering Program** reasonably designed to interdict transactions prohibited by the U.S. Treasury Department's Office of Foreign Assets Control

("OFAC"). Again, based on the institution's risk profile and risk assessment, the Filtering Program should, among other things, include "end-to-end, pre- and post-implementation testing" and be subject to ongoing analysis to assess the logic and performance of the technology.

By continuing to stipulate specific elements for each program, the Final Rule contrasts with the less specific and prescriptive federal standards. There have, however, been helpful changes from the Proposed Rule. For example, the Final Rule explicitly notes that the Transaction Monitoring and Filtering Programs should be risk-based and that a covered financial institution must adopt the specified elements only "to the extent applicable" to that institution (the Proposed Rule described the specified elements as minimum requirements).

Similarly, under the Final Rule, a covered institution may continue to follow industry practice to review periodically the effectiveness of its AML systems and make appropriate revisions, provided that both the assessment process and the remedial efforts are documented and made available to the NYDFS. The Proposed Rule, by contrast, would have restricted such updates unless the covered institution could affirmatively demonstrate that the purpose was not to avoid or minimize the filing of suspicious activity reports. Like many commenters, Debevoise & Plimpton expressed significant concern about this provision; its removal from the Final Rule is welcome.

### **What Is the Final Certification Requirement?**

Each covered institution must adopt and submit annually to the Superintendent a "Compliance Finding" in the form set out in an exhibit to the Final Rule, certifying that the institution is in compliance with the Final Rule. Specifically, either a Senior Officer or the Board of Directors (the "certifying person") must certify that:

- The certifying person has reviewed documents, reports, certifications and opinions necessary to adopt the Compliance Finding;
- The certifying person has taken all necessary steps to confirm that the Transaction Monitoring and Filtering Programs comply with the Final Rule; and
- To the best of the certifying person's knowledge, the Transaction Monitoring and Filtering Programs, for the previously ended year, comply with the Final Rule.

In the Final Rule, the NYDFS permits either a "senior officer" or the board of directors (each of whom must sign) to file the required certification, which

option addresses the concern raised by many that the proposal would have placed an undue burden on individual compliance officers.

As noted above, the Proposed Rule contained an explicit reference to potential criminal penalties. Specifically, NYDFS had included the following statement in the proposal: “A Certifying Senior Officer who files an incorrect or false Annual Certification also may be subject to criminal penalties for such filing.” This language has been omitted. The Final Rule instead states the regulation will be enforced pursuant to the NYDFS’ “authority under any applicable laws.”

### IMPLICATIONS, DIFFICULTIES AND OPEN QUESTIONS

- **Timing of Compliance.** As noted, the Final Rule is effective January 1, 2017, with the first board resolution or senior officer(s) compliance findings due April 15, 2018. These deadlines are fast approaching and require covered institutions to act expeditiously to institute the required programs. This obligation also will add to the compliance burden posed by FinCEN’s recently finalized customer due diligence rule.<sup>2</sup>
- **Cost of Compliance.** For some institutions, the cost of implementing the required changes may be high. With less than 18 months before the first certifications are mandated, covered institutions must conduct appropriate risk assessments (or ensure existing risk assessments are adequate), determine whether current systems and processes for transaction monitoring and OFAC screening meet the requirements of the Final Rule and implement any necessary modifications or updates to the related programs.
- **Ambiguity.** The Final Rule in several instances does not provide clear standards and may pose compliance challenges. For example, requirements of the Transaction Monitoring Program contain many technical terms—such as data mapping, transaction coding, model validation and detection scenario logic—that are not defined in the regulation. Implementation of these requirements may look different at each institution, and it is not clear how the NYDFS will seek to assess

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<sup>2</sup> For a client update on the new FinCEN customer due diligence rule, see “FinCEN Issues New Rule Requiring Identification of Beneficial Owners and Risk-Based Customer Due Diligence” (May 16, 2016), available [here](#).

covered institutions' efforts to comply (and whether the supervisory process will be more exacting than the text of the Final Rule).

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Please contact any of the authors with questions or for additional information. In addition, for e-mail updates on sanctions and related anti-money laundering developments, please subscribe to the Debevoise & Plimpton Sanctions Alert, a monthly summary of developments in economic and trade sanctions. To subscribe, please e-mail [sanctions@debevoise.com](mailto:sanctions@debevoise.com) or sign up at the [Insights Subscribe Page](#) on our website. The firm's sanctions-related publications may also be found at [The Sanctions Resource](#) page on our website.

## Appendix – Redline of Proposed and Final Rule

### Part 504

#### BANKING DIVISION TRANSACTION MONITORING AND FILTERING PROGRAM REQUIREMENTS AND CERTIFICATIONS

(Statutory authority: Banking Law §§37(3)(4); Financial Services Law  
§302)

#### Sec.

#### § 504.1 Background

#### § 504.2 Definitions

#### § 504.3 Transaction Monitoring and Filtering Program Requirements

#### § 504.4 Annual Certifications

#### § 504.5 Penalties/Enforcement Actions

#### § 504.6 Effective Date

#### **§ 504.1 Background.**

The Department of Financial Services (the “Department”) has ~~recently~~ been involved in ~~a number of~~ investigations into compliance by Regulated Institutions, as defined below, with applicable Bank Secrecy Act/Anti-Money Laundering laws and regulations<sup>1</sup> (“BSA/AML”) and Office of Foreign Assets Control of the Treasury Department (“OFAC”)<sup>2</sup> requirements implementing federal economic and trade sanctions.<sup>3</sup>

As a result of these investigations, the Department ~~has become aware of the identified~~ shortcomings in the transaction monitoring and filtering programs of these institutions ~~and that attributable to~~ a lack of robust governance, oversight, and accountability at senior levels ~~of these institutions has contributed to these shortcomings. The~~ Based on not only this experience, but also its regular examinations for safety and soundness, along with other factors, the Department ~~believes~~ has reason to believe that ~~other~~ financial institutions ~~may also~~ have shortcomings in their transaction monitoring ~~programs for monitoring transactions~~

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<sup>1</sup> With respect to federal laws and regulations, see 31 U.S.C. § 5311, et seq. and 31 CFR Chapter X. For New York State regulations, see Part 115 (3 NYCRR 115), Part 116 (3 NYCRR 116), Part 416 (3 NYCRR 416) and Part 417 (3 NYCRR 417).

<sup>2</sup> 31 CFR part 501 et seq.

<sup>3</sup> For information regarding the United States Code, the Code of Federal Regulations and the Federal Register, see Supervisory Policy G-1.

~~for suspicious activities, and watch list~~ and filtering programs, ~~for “real-time” interdiction or stopping of transactions on the basis of watch lists, including OFAC or other sanctions lists, politically exposed persons lists, and internal watch lists.~~

~~To address these deficiencies~~ As a result, the Department has determined to clarify the required attributes of a Transaction Monitoring and Filtering Program and to require ~~a Certifying Senior Officer, as defined below, of Regulated Institutions, to file Annual Certifications, in the form set forth herein, regarding compliance by their institutions with the standards described in this Part,~~ that the Board of Directors or Senior Officer(s), as applicable, of each Regulated Institution submit to the Superintendent annually a Board Resolution or Compliance Finding, as defined in this Part, confirming the steps taken to ascertain compliance by the Regulated Institution with this Part.

This regulation implements these requirements.

#### **§ 504.2 Definitions.**

The following definitions apply in this Part:

- (a) ~~“Annual Certification” means a certification~~ Board Resolution or Senior Officer Compliance Finding” means a board resolution or senior officer(s) finding in the form set forth in Attachment A.
- (b) “Bank Regulated Institutions” means 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.
- (c) ~~“Certifying Senior Officer” means the institution’s chief compliance officer or their~~ Board of Directors” means the governing board of every Regulated Institution or the functional equivalent if the Regulated Institution does not have a Board of Directors.
- (d) “Nonbank Regulated Institutions” shall mean all check cashers and money transmitters licensed pursuant to the Banking Law.
- (e) “Regulated Institutions” means all Bank Regulated Institutions and all Nonbank Regulated Institutions.
- (f) “Risk Assessment” means an on-going comprehensive risk assessment, including an enterprise wide BSA/AML risk assessment, that takes into account the institution’s size, staffing, governance, businesses, services, products, operations, customers, ~~counterparties,~~ other relations and

their locations, as well as the geographies and locations of its operations and business relations;

- (g) “Senior Officer(s)” shall mean the senior individual or individuals responsible for the management, operations, compliance and/or risk of a Regulated Institution including a branch or agency of a foreign banking organization subject to this Part.
- (gh) “Suspicious Activity Reporting” means a report required pursuant to 31 U.S.C. § 5311 et seq. that identifies suspicious or potentially suspicious or illegal activities.
- (hi) “Transaction Monitoring Program” means a program that includes the attributes specified in Subdivisions (a), (c) and (d) of Section 504.3.
- (ij) ~~“Watch List Filtering Program”~~ means a program that includes the attributes specified in Subdivisions (b), (c) and (d) of Section 504.3.
- (k) “Transaction Monitoring and Filtering Program” means a Transaction Monitoring Program, and a ~~Watch List Filtering Program~~, collectively.

#### **§ 504.3 Transaction Monitoring and Filtering Program Requirements.**

(a) Each Regulated Institution shall maintain a Transaction Monitoring Program reasonably designed for the purpose of monitoring transactions after their execution for potential BSA/AML violations and Suspicious Activity Reporting, which system may be manual or automated, and which shall, ~~at a minimum~~ include the following attributes, to the extent they are applicable:

1. be based on the Risk Assessment of the institution;
2. be reviewed and periodically updated at risk-based intervals to take into account and reflect ~~all current~~ changes to applicable BSA/~~AML~~ AM L laws, regulations and ~~alerts~~ regulatory warnings, as well as any ~~relevant~~ other information ~~available~~ determined by the institution to be relevant from the institution’s related programs and initiatives, ~~such as “know your customer due diligence”, “enhanced customer due diligence” or other relevant areas, such as security, investigations and fraud prevention;~~
3. ~~map~~ appropriately match BSA/AML risks to the institution’s businesses, products, services, and customers/counterparties;
4. ~~utilize~~ BSA/AML detection scenarios ~~that are based on the institution’s Risk Assessment~~ with threshold values and amounts ~~set~~ designed to

detect potential money laundering or other suspicious or illegal activities;

5. ~~include an~~ end-to-end, pre-and post-implementation testing of the Transaction Monitoring Program, including, as relevant, a review of governance, data mapping, transaction coding, detection scenario logic, model validation, data input and Program output, ~~as well as periodic testing~~;
6. ~~include easily understandable~~ documentation that articulates the institution's current detection scenarios and the underlying assumptions, parameters, and thresholds;
7. ~~include investigative~~ protocols detailing setting forth how alerts generated by the Transaction Monitoring Program will be investigated, the process for deciding which alerts will result in a filing or other action, ~~who is~~ the operating areas and individuals responsible for making such a decision, and how the investigative and decision-making process will be documented; and
8. be subject to an on-going analysis to assess the continued relevancy of the detection scenarios, the underlying rules, threshold values, parameters, and assumptions.

(b) Each Regulated Institution shall maintain a ~~Watch List~~ Filtering Program, which may be manual or automated, reasonably designed for the purpose of interdicting transactions, ~~before their execution, that are prohibited by applicable sanctions, including OFAC and other sanctions lists, and internal watch lists, which system may be manual or automated~~ OFAC, and which shall, ~~at a minimum,~~ include the following attributes, to the extent applicable:

1. be based on the Risk Assessment of the institution;
2. be based on technology, processes or tools for matching names and accounts<sup>4</sup>, in each case based on the institution's particular risks, transaction and product profiles;

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<sup>4</sup> The technology used in this area ~~by some firms is~~ may be based on automated tools that develop matching algorithms, such as those that use various forms of so-called "fuzzy logic" and culture-based name conventions to match names. This regulation does not mandate the use of any particular technology, only that the system or technology used must be ~~adequate to capture~~ reasonably designed to identify prohibited transactions.

3. ~~include an~~ end-to-end, pre- and post-implementation testing of the ~~Watch List~~ Filtering Program, including, as relevant, a review of data mapping~~matching~~, an evaluation of whether the ~~watch lists~~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 ~~Watch List Filtering~~ Program output;
  4. ~~utilizes watch lists that reflect current legal or regulatory requirements;~~
- ~~54.~~ be subject to on-going analysis to assess the logic and performance of the technology or tools for matching names and accounts, as well as the ~~watch lists~~OFAC sanctions list and the threshold settings to see if they continue to map to the risks of the institution; and
- ~~65.~~ ~~include easily understandable~~ documentation that articulates the intent and ~~the~~ design of the Filtering Program tools, processes or technology.
  - (c) Each Transaction Monitoring and Filtering Program shall, ~~at a minimum,~~ require the following, to the extent applicable:
    1. identification of all data sources that contain relevant data;
    2. validation of the integrity, accuracy and quality of data to ensure that accurate and complete data flows through the Transaction Monitoring and Filtering Program;
    3. data extraction and loading processes to ensure a complete and accurate transfer of data from its source to automated monitoring and filtering systems, ~~if~~if automated systems are used;
    4. 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;
    5. 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;
    6. funding to design, implement and maintain a Transaction Monitoring and Filtering Program that complies with the requirements of this Part;
    7. qualified personnel or outside ~~consultant~~consultant(s) responsible for the design, planning, implementation, operation, testing, validation, and ~~ongoing~~on-going 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

8. periodic training of all stakeholders with respect to the Transaction Monitoring and Filtering Program.

(d) ~~No~~To the extent a Regulated Institution ~~may make changes or alterations to the Transaction Monitoring and Filtering Program to avoid or minimize filing suspicious activity reports, or because the institution does not have the resources to review the number of alerts generated by a Program established pursuant to the requirements of this Part, or to otherwise avoid complying with regulatory requirements,~~has identified areas, systems, or processes that require material improvement, updating or redesign, the Regulated Institution shall document the identification and the remedial efforts planned and underway to address such areas, systems or processes. Such documentation must be available for inspection by the Superintendent.

**§ 504.4 Annual ~~Certification~~Board Resolution or Senior Officer(s) Compliance Finding.**

To ensure compliance with the requirements of this Part, each Regulated Institution shall adopt and submit to the ~~Department by April 15th of each year~~Superintendent a Board Resolution or Senior Officer(s) Compliance Finding in the form set forth in Attachment A: by April 15th of each year. Each Regulated Institution shall maintain for examination by the Department all records, schedules and data supporting adoption of the Board Resolution or Senior Officer(s) Compliance Finding for a period of five years.

**§ 504.5 Penalties/Enforcement Actions.**

~~All Regulated Institutions shall be subject to all applicable penalties provided for by the Banking Law and the Financial Services Law for failure to maintain a Transaction Monitoring Program, or a Watch List Filtering Program complying with the requirements of this Part and for failure to file the Certifications required under Section 504.4 hereof. A Certifying Senior Officer who files an incorrect or false Annual Certification also may be subject to criminal penalties for such filing.~~

This regulation will be enforced pursuant to, and is not intended to limit, the Superintendent's authority under any applicable laws.

**§ 504.6 Effective Date.**

This Part shall be effective ~~immediately. It shall apply to all State fiscal years beginning with the Fiscal Year starting on April 1, 2017.~~ January 1, 2017. Regulated Institutions will be required to prepare and submit to the Superintendent Annual Board Resolutions or Senior Officer(s) Compliance Findings under § 504.4 commencing April 15, 2018.

ATTACHMENT A

(Regulated Institution Name)

APRIL 15, 20

**Annual ~~Certification~~ Board Resolution or Senior Officer(s)  
Compliance Finding For Bank Secrecy Act/~~Anti-Money~~ Anti- Money  
Laundering and  
Office of Foreign Asset Control Transaction Monitoring and Filtering  
Program**

~~Programs  
to-~~

~~New York State Department of Financial Services-~~

~~In~~ Whereas, in compliance with the requirements of the New York State Department of Financial Services (the "Department") that each Regulated Institution maintain ~~a~~ Transaction Monitoring and Filtering Program ~~satisfying all the requirements of Section 504.3 and that a Certifying Senior Officer of a Regulated Institution sign an annual certification attesting to the compliance by such institution with the requirements of Section 504.3, each of the undersigned hereby certifies that they have reviewed, or caused to be reviewed, the Transaction Monitoring Program~~ in compliance with Section 504.3; and

Whereas, Section 504.4 requires that the Board of Directors or a Senior Officer(s), as appropriate, adopt and submit to the Superintendent a Board Resolution or Senior Officer Compliance Finding confirming its or such individual's findings that the Regulated Institution is in compliance with Section 504.3 of this Part 504;

NOW, THEREFORE, the Board of Directors or Senior Officer certifies:

- (1) The Board of Directors (or name of Senior Officer(s)) has reviewed documents, reports, certifications and opinions of such officers, employees, representatives, outside vendors and other individuals or entities as necessary to adopt this Board Resolution or Senior Officer Compliance Finding;
- (2) The Board of Directors or Senior Officer(s) has taken all steps necessary to confirm that (name of Regulated Institution) has a Transaction Monitoring and Filtering Program that complies with the provisions of Section 504.3; and

~~and the Watch List~~ (3) To the best of the (Board of Directors) or (name of Senior Officer(s)) knowledge, the Transaction Monitoring and the

Filtering Program (~~the 'Programs'~~) of (name of Regulated Institution) as of \_\_\_\_\_ (date of the ~~Certification~~Board Resolution or Senior Officer(s) Compliance Finding) for the year ~~ended-ended~~ \_\_\_\_\_ (year for which ~~certification~~Board Resolution or Compliance Finding is provided) ~~and hereby certifies that the Transaction Monitoring and Filtering Program complies with all the requirements of~~ Section 504.3.

Signed by each member of the Board of Directors or Senior Officer(s)

~~By signing below, the undersigned hereby certifies that, to the best of their knowledge, the above statements are accurate and complete.~~

~~Signed:~~

~~(Name:)~~ \_\_\_\_\_

~~Date:~~ \_\_\_\_\_

~~Chief Compliance Officer or equivalent~~

~~**Text of proposed rule and any required statements and analyses may be obtained from:** Gene C. Brooks, New York State Department of Financial Services, One State Street, New York, NY 10004, (212) 709-1663, email: Gene.Brooks@dfs.ny.gov~~

~~**Data, views or arguments may be submitted to:** Same as above.~~

~~**Public comment will be received until:** 45 days after publication of this notice.~~