


DFS final regulation

Are you really ready for an
era of increased accountability
in AML monitoring and OFAC
sanctions screening?

The background of the image is a collage of various international banknotes and coins. Visible include a US one-dollar bill at the top, a Japanese five-thousand Yen note, a green Euro 100 note, a pink Euro 10 note, and a US quarter coin. A central yellow rectangular box contains the following text:

On June 30, 2016, the New York Department of Financial Services (DFS) issued its final regulation on Bank Secrecy Act/Anti-Money Laundering (BSA/AML) transaction monitoring and Office of Foreign Assets Control of the Treasury Department (OFAC) filtering/screening requirements. The first written rule of its kind, the final regulation deconstructs the key components of transaction monitoring and filtering programs that must be implemented by DFS regulated institutions. The requirements culminate with an annual mandated submission by the Board of Directors or a Senior Officer certifying compliance with the regulation and the steps taken to achieve it. While the requirements may not be viewed as new, the level of detail and testing necessary to demonstrate they are performing as they should be may come as a surprise to some Regulated Institutions. Initial reviews may discover the need for additional investigations or data analysis. Further, an escalation process to achieve the appropriate sign-offs will need to be established and well-documented at each step. Institutions should not underestimate the amount of time and detail the implementation of these measures will entail.

DFS final regulation

DFS final regulation on AML monitoring and OFAC sanctions screening – Are you really ready?

Applicability of the regulation

Section §504.2.6 of the final regulation, which remains unchanged from the December 2015 draft, states that “‘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... and all branches and agencies of foreign banking corporations licensed... to conduct banking operations in New York.”

The regulation is effective as of January 1, 2017, with the first compliance findings due April 15, 2018. Regulated Institutions, as defined in the regulation, may have to implement many changes to be in compliance with this new regulation. Some of the key requirements that comprise this new regulation are highlighted below. Some requirements may present a significant undertaking for Regulated Institutions.

DFS stresses “tone at the top”

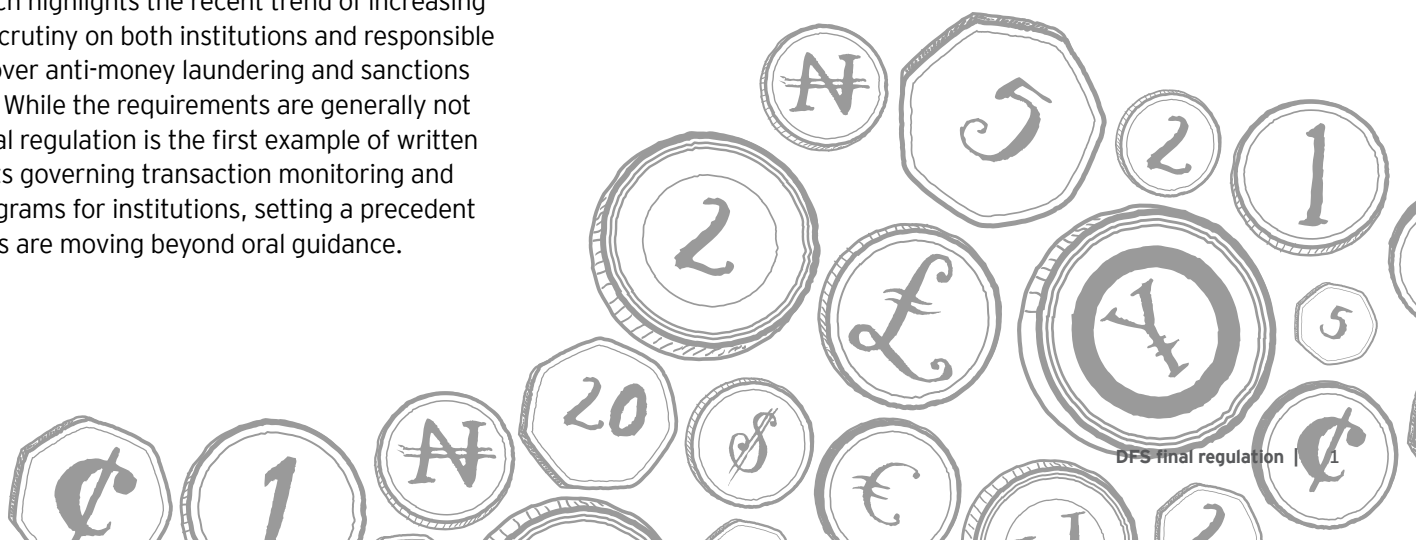
The DFS regulation was prompted by its findings of “identified shortcomings in the transactions monitoring and filtering programs” of certain financial institutions. DFS attributed the shortcomings, at least in part, to “a lack of robust governance, oversight and accountability at senior levels.” Certain Regulated Institutions have already been required to conduct additional reviews and AML look-backs to comply with DFS expectations. The final regulation requires Regulated Institutions to implement, oversee and update AML monitoring and OFAC filtering programs, and to document how they did so. This will culminate in annual certification by either the Board of Directors or a Senior Officer, as defined in the regulation, responsible for compliance or risk of the Regulated Institution.

This approach highlights the recent trend of increasing regulatory scrutiny on both institutions and responsible individuals over anti-money laundering and sanctions compliance. While the requirements are generally not new, the final regulation is the first example of written requirements governing transaction monitoring and filtering programs for institutions, setting a precedent as regulators are moving beyond oral guidance.

Revisions from proposed regulation

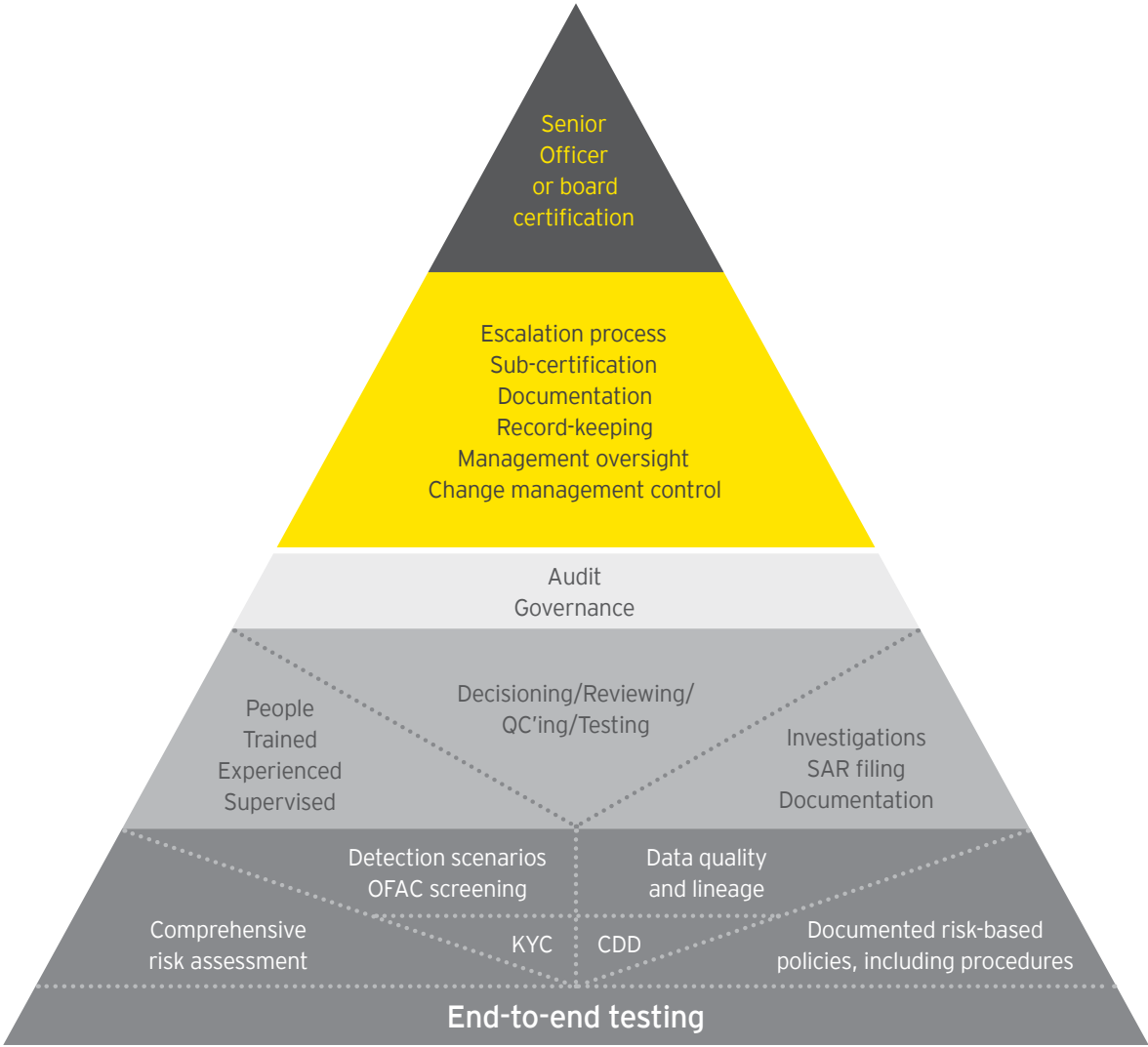
After receiving comments from the industry, the DFS made several changes to the proposed regulation in December 2015. Some viewed the changes as making the regulation less stringent; however, the risk-based regulation should not be underestimated. Some of the changes from the proposed regulation include the following:

- ▶ **Certification of annual compliance finding:** The earlier draft of the DFS regulation proposed that a senior compliance officer sign the certificate of annual compliance finding, with criminal liability provisions for deficient monitoring and filtering programs. The final requirement specifies “under any applicable laws,” and allows either a Senior Officer(s) or the Board to sign the certificate.
- ▶ **Easing of “tuning” restrictions:** The proposed DFS regulation included a strict requirement that Regulated Institutions could not make changes to their monitoring and filtering programs to reduce the quantity of SARs that they would be required to file. The final regulation states that areas that require improvement should be remedied and documented for inspection by the DFS.
- ▶ **Filter changes:** The final regulation explicitly limits filtering programs to OFAC sanctions lists, and doesn't include internal watch or PEP lists.
- ▶ **Qualifying language:** The final rule contains some qualifying language, such as “as relevant” and “to the extent applicable.” However, certain broadly defined terms in the final regulation add a degree of uncertainty that will require Regulated Institutions to stay on top of the changing regulatory landscape.





Components of transaction monitoring and filtering programs



Different functionalities across an institution have to seamlessly communicate and collaborate with each other in order to maintain an effective and sustainable transaction monitoring and filtering program. This is important for a Senior Officer or Board to accurately certify compliance under the regulation.



What hangs in the balance?



Instances of program deficiency or noncompliance may result in investigations, deeper forensic data analytics and look-backs potentially culminating in monetary fines or enforcement actions by the DFS.



Risk-based approach

The regulation specifically stipulates an “end-to-end, pre- and post-implementation testing” of the program, encompassing a review of several specific aspects of the program including “governance, data mapping, transaction coding, detection scenario logic, model validation, data input, and Program output.”

Additionally, the regulation requires that BSA/AML transaction monitoring and OFAC filtering programs be based on a tailored comprehensive risk assessment of the Regulated Institution. To be comprehensive, the risks must be assessed against product, geography and customer type, also considering any audit or other findings that have found weaknesses in the program. Once established, the risk assessment and the programs must be reviewed, analyzed, tested and updated periodically. Additionally, defined threshold values and amounts within the detection scenarios, as well as details of protocols of the investigation of generated alerts, must be fully documented.

Data integrity and data lineage

The transaction monitoring and filtering programs should identify the data sources and validate the quality of the data as it flows from its source into the monitoring and filtering programs.

The specific aspects of this requirement include the identification of all data sources, data extraction and loading processes to achieve accurate transfer and vendor selection processes, among others.


Even the largest Regulated Institutions may grapple with challenges as they introduce new systems or programs and quality assurance processes to meet this requirement. These challenges will be compounded by the convergence of different information technology systems used throughout the various departments of a large organization. Additional data analysis or mapping may be required to document compliance.

Program oversight and accountability

While maintaining their monitoring and filtering programs, Regulated Institutions must take responsibility to ensure that changes are made to the programs when needed, and such changes are documented and controlled through a change management process. Additionally, they must document the vendor selection process (if the process is outsourced to a vendor), have adequate funding and qualified professionals for these programs, and periodically train stakeholders in regards to these programs.

Annually, through a Senior Officer(s) sign-off or a Board Resolution, Regulated Institutions have to submit a certified compliance finding to the DFS that they have met the requirements of the regulation. Specifically, this must include that those providing the certified compliance finding have: (1) reviewed the documents, (2) taken steps to confirm that the transaction monitoring and filtering programs comply with the final regulation and (3) affirmed that, to the best of their knowledge, the programs are compliant. A well-documented escalation process will need to be in place in order for Regulated Institutions to provide the compliance finding with the level of detail and certainty the regulation requires. The regulation does not specify what a Regulated Institution should do if it cannot certify that all components of the programs are in compliance because shortcomings have been discovered. Presumably there will be prior self-disclosures, but the timing at which these must be submitted is not clear.

While it is likely that the Senior Officer will be providing the compliance finding more often than the Board, it must be expected that the Board is fully briefed, trained and aware of the underlying detail of the programs. In addition, Senior Compliance and Risks Officers and CEOs will have to set the tone and expectation that complying with these requirements is strategically important to the success of the Regulated Institution.



Qualified personnel

The regulation, including the current discussions about its impact, focuses on the significant amount of work required to maintain an acceptable comprehensive risk assessment, as well as the technology, testing and documentation of all the applicable systems in order to produce accurate results based on identified risks. The next phase of these programs, which is the review and decisioning by personnel of the results produced, cannot be overlooked. The regulation requires protocols for how alerts generated are investigated, including the individuals responsible for making such decisions. While well-managed and functioning systems are necessary, they exist in large part to provide information to individuals for review to determine what, if any, additional action is required when alerts or hits are triggered. While not specified in the regulation, it should be understood that to demonstrate adequate governance and oversight, the DFS will expect that the personnel involved are trained, skilled, experienced and appropriately supervised.



Implications and challenges ahead

1. Federal and other state agencies, especially those that also audit DFS regulated institutions, may adopt much of this approach of increased regulation and even document regulation within their own jurisdictions with respect to transaction monitoring and filtering programs. Additionally, Regulated Institutions will be working to comply with this regulation simultaneously with other recent regulation, such as FinCEN's regulation on beneficial ownership and customer due diligence, adding the fifth pillar to the AML compliance program. This must be a coordinated effort from both a risk assessment and technology standpoint, adding to the complexity of the implementation.
2. The thoroughness of the transaction monitoring and filtering program requirements calls for the integration of business functionalities, such as the internal audit and compliance departments. The ongoing program oversight and optimization requirements may generate a need for a greater number of trained and experienced AML compliance-dedicated personnel and resources.
3. Regulated institutions that do not have robust monitoring of data quality as information moves through varying systems may encounter challenges as they attempt to integrate different information systems into a cohesive program.
4. There is an increasing emphasis on the importance of tone at the top, as well as the assumption of individual liability. The Yates Memo issued on September 2015 regarding "Individual Accountability for Corporate Wrongdoing" specifically emphasized the consequences that individuals in organizations may face. Senior officials certifying parts of the program or the final finding in particular should take note of their tone at the top and seek to enforce a strong compliance environment throughout their organizations.

Despite these anticipated challenges, institutions will encounter unique situations while planning and implementing the requisite control framework. There may also be resulting impacts on data, requiring enhanced forensic data analytics and historical transaction analyses, with which EY is able to assist.

Questions to consider

- ▶ What are the steps to delegating compliance responsibilities throughout different departments and/or third-party vendors to create a seamless BSA/AML/OFAC compliance program?
- ▶ Are adequate and appropriate resources in place to create, monitor and test as necessary the required risk assessment, technology needs and investigation practices within the time requirements?
- ▶ How will the DFS assess the effectiveness of institution programs?
- ▶ What impact will the final rule have on federal and other state authorities?
- ▶ What are the implications of the final rule to foreign branches and subsidiaries of Regulated Institutions?

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SCORE No. 02582-161US
CSG No. 1607-2003827 NE
ED None

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