

Client Alert

International Trade & Litigation Practice Group

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New York Department of Financial Services Intensifies AML Enforcement Under New Superintendent

Superintendent of New York State Department of Financial Services (“NYDFS”), Maria T. Vullo, has focused the Department’s efforts on enforcement of New York’s Anti-Money Laundering (“AML”) laws. Since her confirmation on June 15, 2016, NYDFS has levied several fines, each over \$150 million, against financial institutions operating in New York, and instituted new AML program requirements through a regulation that became effective on January 1, 2017. This Client Alert discusses three of the more significant fines issued by NYDFS and provides an overview of the new regulation.

Recent New York AML Fines Exceed \$1B

Over the last several months, NYDFS has levied fines against three large banks, the sum of which exceeds \$600 million. Each of the fined banks also will be subject to ongoing independent oversight of some kind (*e.g.*, in the form of an independent monitor or an independent consultant). The pace and size of these penalties represent an increase in activity for NYDFS with respect to AML enforcement.

As is made clear from the consent orders discussed below, NYDFS found that each of the penalized banks had systemic compliance issues, such as oversight deficiencies, lack of buy in from senior level management, or weak transaction monitoring and filtering programs, which the new AML regulation seeks to address.

Mega International Commercial Bank of Taiwan – \$180M

On August 19, 2016, NYDFS announced that Mega International Commercial Bank of Taiwan (“Mega Bank”) would pay a \$180 million penalty and hire an independent monitor for two years for violations of New York’s AML laws. The violations were uncovered during a routine NYDFS examination.

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As discussed in the consent order, NYDFS determined that: (i) key personnel in Mega Bank's compliance department, including Mega Bank's chief compliance officer, lacked familiarity with U.S. regulatory requirements and had conflicted interests due to the fact the compliance officer had key business and operational responsibilities within the company, (ii) compliance staff failed to periodically review suspicious transactions detected by surveillance monitoring filters, and (iii) the New York branch compliance procedures were inadequate, as they provided virtually no guidance concerning the reporting of continuing suspicious activities, had inconsistent compliance directives, and failed to determine whether foreign affiliates had adequate AML controls in place.

Agricultural Bank of China \$215M

On November 4, 2016, NYDFS announced that the Agricultural Bank of China would pay a \$215 million penalty and install an independent monitor for violations of New York's AML laws. The NYDFS investigation found that the Agricultural Bank of China engaged in intentional wrongdoing, such as obfuscating U.S. dollar transactions conducted through its New York Branch that might reveal violations of sanctions or anti-money laundering laws.

As discussed in the consent order, NYDFS determined that: (i) compliance personnel at the New York branch were ignored even after repeatedly warning headquarters of problematic transaction patterns, (ii) the branch was not able to retain a qualified, permanent chief compliance officer, and (iii) senior officials did not adequately monitor remediation of prior examination deficiencies.

Intesa Sanpalo \$235M

On December 15, 2016, NYDFS announced that Intesa Sanpaolo S.A. ("Intesa") would pay a \$235 million penalty and extend the term of its current independent consultant for violations of New York's AML laws. These violations included compliance failures over several years which stemmed from deficiencies in Intesa's implementation and oversight of its transaction monitoring system.

As discussed in the consent order, NYDFS determined that Intesa: (i) missed thousands of alerts generated by its transaction monitoring systems, (ii) clearance practices for such alerts did not follow internal procedures, as Intesa's compliance officer believed the alerts identified many "false positives," (iii) Intesa's compliance officer permitted individual reviewers too much discretion to clear transactions, and (iv) certain employees appeared to have received training regarding how to obfuscate Iran-related transactions.

NYDFS Investigations Leads to New Anti-Money Laundering Regulation

NYDFS implemented the new anti-money laundering regulation in response to a pattern of violations. Specifically, as a result of its investigations, NYDFS identified shortcomings in the transaction and monitoring and filtering programs of regulated financial institutions. *See* 23 NYCCR §504.1. Moreover, NYDFS attributed these shortcomings to a lack of governance, oversight and accountability at senior levels of regulated entities. *See* 23 NYCCR §504.1.

There are three primary aspects of the new regulation: (i) a transaction monitoring program requirement, (ii) a filtering program requirement, and (iii) a new annual certification requirement. The annual certification requirement may expose senior officials to increased liability. We discuss each of these requirements below:

- *Transaction Monitoring Program* – Each regulated institution must maintain a transaction monitoring program reasonably designed for the purpose of monitoring transactions after their execution for potential AML violations and suspicious activity. The transaction monitoring program may be designed by the regulated entity, but any such program must, to the extent practicable:
 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 changes to applicable BSA/AML laws, regulations and regulatory warnings, as well as any other information determined by the institution to be relevant from the institution's related programs and initiatives;
 3. Appropriately match BSA/AML risks to the institution's businesses, products, services, and customers/counterparties;
 4. Include BSA/AML detection scenarios with threshold values and amounts designed to detect potential money laundering or other suspicious or illegal activities;
 5. Contain 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;
 6. Maintain documentation that articulates the institution's current detection scenarios and the underlying assumptions, parameters, and thresholds;
 7. Institute protocols 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, 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.
- *Filtering Program* – Similarly, each regulated institution must maintain a filtering program reasonably designed for the purpose of interdicting transaction prohibited by OFAC. The filtering may also be designed by the regulated entity, however, any such program must, to the extent practicable:
 1. Be based on the Risk Assessment of the institution;

2. Be based on technology, processes or tools for matching names and accounts, in each case based on the institution's particular risks, transaction and product profiles;
3. Contain 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;
4. 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 OFAC sanctions list and the threshold settings to see if they continue to map to the risks of the institution; and
5. Maintain documentation that articulates the intent and design of the filtering program tools, processes or technology

Annual Certification – Finally, each regulated institution is required to adopt and submit to NYDFS either a Board Resolution or a Senior Officer compliance finding (“Compliance Finding”), in the form proscribed by NYDFS, no later than April 15th each year. The first Compliance Finding is due on April 15, 2018.

As a part of the Compliance Finding, the designated signatory must certify that he or she:

1. Has reviewed documents, reports, certifications and opinions of such officers, employees, representatives, outside vendors and other individuals or entities as necessary to the Compliance Finding;
2. Has taken all steps necessary to confirm that the transaction monitoring and filtering program complies with the regulation; and
3. to the best of their knowledge, has ensured that the transaction monitoring and filtering program for the subject year actually complies with the regulation.

The annual certification obligation is not required under federal AML/ BSA rules and would likely expose the certifier to additional liability under New York's regulations. It is important to note, however, that the final rule did not adopt the explicit reference to individual criminal liability that was in the proposed rule. Nevertheless, it is clear that one of the goals of the new regulation is to force senior leaders to be aware of and be involved in a company's compliance efforts, and to the extent NYDFS determines a company's senior leaders are not adequately involved, it seems probable that it will use this new regulation to impose some penalty on the individual(s) providing the certification.

Conclusion

Given the recent activity from New York, entities regulated by NYDFS should consider reviewing their transaction monitoring and filtering program, and, where prudent, enhance existing programs to ensure they are reasonably designed to meet NYDFS' stated objectives. Such a review may warrant a gap analysis, risk assessment, and an analysis of systemic issues to ensure that risks associated with money laundering are adequately and thoroughly addressed.

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