



March 21, 2016

Gene C. Brooks  
New York State  
Department of Financial Services  
One State Street  
New York, NY 10004

Re: Notice of Proposed Rulemaking: Regulating Transaction Monitoring and Filtering Systems Maintained by Banks, Check Cashers and Money Transmitters

Dear Mr. Brooks:

The Clearing House Association L.L.C.<sup>1</sup> appreciates the opportunity to provide our comments on the proposal by the New York Department of Financial Services (“**NYDFS**”) under New York Banking Law, Sections 37(3),(4) and 672 and New York Financial Services Law Section 302 to (i) specify the required attributes of Transaction Monitoring and Filtering Programs that New York State chartered banks and other NYDFS-regulated institutions (“**Regulated Institutions**”) use to comply with the requirements of the federal Bank Secrecy Act and its implementing regulations and guidance (“**BSA**”) and the sanctions programs administered by the Office of Foreign Assets Control (“**OFAC**”) and (ii) impose a new senior officer certification requirement.

The Clearing House is deeply committed to the shared public and private sector objective of detecting and combating financial crimes and terrorist financing, and has long advocated for measures designed to improve banks’ and other institutions’ abilities to combat financial crime. While we strongly support efforts to enhance public and private sector tools to combat money laundering and terrorist financing, we are concerned that certain elements of the proposal would introduce unnecessarily prescriptive and potentially problematic requirements into a rapidly

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<sup>1</sup> The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

evolving and dynamic area and, in the case of the proposal's certification requirement, may well undermine rather than enhance the ability of financial institutions to develop and implement effective anti-money laundering (“**AML**”) and counterterrorism financing (“**CFT**”) programs. For these reasons, we strongly suggest that, as an alternative to the proposal, the NYDFS instead work to achieve its underlying objectives through public/private sector dialogue and enhanced supervisory focus on Transaction Monitoring and Filtering Program practices. In that regard, we believe that the objectives of the proposal would be served more effectively if the NYDFS were to articulate its expectations in a supervisory policy without the proposed certification requirement applicable to an institution’s chief compliance officer or their functional equivalent (“**CCO**”), rather than by regulation, and that those expectations be reviewed as part of Regulated Institutions’ BSA internal audit programs. This approach would help the NYDFS to achieve its goal of ensuring that Regulated Institutions have robust AML/CFT Transaction Monitoring and Filtering Programs while avoiding, among other negative consequences, the likely counterproductive effects of the proposed certification requirement.

Part I of this letter sets forth an executive summary of our comments. Part II discusses the shortcomings of the proposed CCO certification, namely, that it will not enhance compliance and will be counterproductive to enhancing Regulated Institutions’ AML/CFT compliance programs. Part III describes the existing BSA/AML/OFAC federal framework and the duplicative and potentially conflicting requirements set forth in the proposal. Part IV specifically describes the additional Transaction Monitoring and Filtering requirements that would be imposed on Regulated Institutions and how those requirements are, in some instances, redundant with existing expectations and practices, and, in other instances, unclear, inflexible, and potentially overly broad in scope. Part V discusses our concerns regarding the proposed prohibition of altering or changing Transaction Monitoring and Filtering Programs. Part VI describes our concerns with the proposed effective date. Finally, Part VII describes our concerns regarding the Regulatory Impact Statement and the Regulatory Flexibility Analysis set forth in the proposal.

## **I. Executive Summary**

- **The proposal would establish specific, prescriptive mandates for Transaction Monitoring and Filtering Programs that are both unnecessary and likely to give rise to confusion and inconsistency relative to the existing federal BSA/AML/OFAC mandates.**

The proposal would layer problematic additional requirements over an existing federal framework that governs the BSA/AML/OFAC compliance efforts of both state-chartered and federally-chartered depository institutions and other financial entities. The proposal thus threatens to create confusion among Regulated Institutions regarding both federal and state

BSA/AML and OFAC-related requirements and an un-level playing field for Regulated Institutions compared to institutions not covered by the proposal.<sup>2</sup>

Further, under this proposal, there may be instances where in the ordinary course of a Regulated Institution's operations, it is placed in the untenable situation where there is a perceived conflict between compliance with the proposal and compliance with the the existing federal BSA/AML/OFAC framework. Therefore, TCH respectfully requests that in such instances, Regulated Institutions be given the opportunity to work with the NYDFS in order to determine how best to proceed.

In addition, the NYDFS cites as its rationale for issuing the proposal its involvement in several recent investigations involving inadequate transaction monitoring and screening processes at Regulated Institutions, and its belief that other institutions may have similar deficiencies.<sup>3</sup> The NYDFS does not present specific evidence to support the suggestion that the deficiencies identified at the relatively small number of target banks subject to those investigations also exist at the hundreds of other Regulated Institutions. TCH believes that more than speculation that other Regulated Institutions have similar deficiencies is required to justify promulgation of the proposal. Further, as evidenced by recent enforcement actions by the NYDFS in this area, the NYDFS already has the legal authority to supervise and examine Regulated Institutions for BSA compliance and take appropriate action to address any deficiencies.

- **The proposal's senior executive certification requirement is likely to undermine, not enhance, financial institutions' ability to develop and implement effective AML/CFT compliance programs.**

TCH believes that the proposal's requirement that each Regulated Institution's CCO certify, under threat of criminal penalties, that the Regulated Institution's "Transaction Monitoring and Filtering Program complies with all the requirements of Section 504.3" would not appreciably enhance, and could detract from, effective maintenance of a robust compliance program at Regulated Institutions by potentially driving talented AML and compliance specialists out of those institutions, due to concerns about their potential individual criminal and civil liability. Further, the proposal, if acted upon, would likely cause Regulated Institutions to

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<sup>2</sup> The proposal applies to "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. We note that New York State credit unions are not covered by the proposal.

<sup>3</sup> See New York State Register Notice, *Regulating Transaction Monitoring and Filtering Systems Maintained by Banks, Check Cashers and Money Transmitters*, New York Department of Financial Services, December 16, 2015.

expend AML/CFT resources on efforts to comply with the proposal, in particular the certification requirement, which would not enhance BSA/AML or OFAC compliance, and further, would divert these resources from current AML/CFT compliance programs.

- **As an alternative to adoption of the proposal, we suggest that the NYDFS instead work to achieve its underlying objectives through enhanced public/private sector dialogue and supervisory focus on Transaction Monitoring and Filtering Program practices.**

The Clearing House respectfully suggests that, as an alternative to adoption of the proposal, the NYDFS instead pursue its stated policy goals through enhanced public/private sector dialogue and a more specific supervisory focus on Transaction Monitoring and Filtering practices. In regards to the former, TCH respectfully suggests that the NYDFS establish a task force that would meet periodically at the NYDFS' request and include representatives from the NYDFS, various interested trade associations and their members, and other interested parties to exchange information about these topics and discuss and identify both industry best practices and supervisory expectations for monitoring programs as each evolves. We believe that the free exchange of such information will help to inform supervisory expectations and foster a greater understanding of those expectations by industry.

In that regard, we believe that the objectives of the proposal would be served more effectively if the NYDFS were to articulate its Transaction Monitoring and Filtering Program expectations as a supervisory policy without the certification requirement, rather than by regulation, and that those expectations be reviewed as part of Regulated Institutions' BSA/AML internal audit programs. This approach would help the NYDFS to achieve its goal of ensuring that Regulated Institutions have robust BSA/AML/OFAC Transaction Monitoring and Filtering Programs while avoiding the likely counterproductive effects of the proposed certification requirement.

## **II. The proposed CCO certification is unnecessary, will not enhance compliance, and is counterproductive.**

The proposal seeks to require a Regulated Institution's senior compliance officer to certify annually that the institution is in compliance with the requirements of the proposal, and explicitly suggests the potential for criminal penalties for the officer if the certification is "incorrect or false." The CCO would also have to certify that he or she reviewed, or caused to be reviewed, those programs. This is perhaps the most concerning provision in the proposal. We submit that the certification requirement is unnecessary, will not enhance compliance in the manner intended by the proposal, and will be counterproductive, as described below.

Although the mandatory certification form accompanying the proposal seems to contemplate penalties only for intentionally false certifications by stating that the certification is made “to the best of the attesting officer’s knowledge,” proposed Section 504.5 provides that any individual who submits an “incorrect or false” certification may be subject to criminal prosecution. Further, the Proposed Regulation does not explicitly provide an “intent” standard for the imposition of criminal penalties. While the certification purports to be based on the certification promulgated under Sarbanes-Oxley (“**SOX**”), those certifications are generally limited by a “materiality” standard. Under SOX, a company’s officers are required to certify that they have designed or caused to be designed systems of controls, while the proposed certification would require the signer to certify not merely that those risk-based programs are reasonably designed to detect money laundering and block sanctioned transactions, but to certify to *actual compliance* with substantive and subjective requirements for AML transaction monitoring and watch list filtering programs. As such, it appears that a certifying officer who, in good faith, submits a certification later deemed “incorrect or false” may nonetheless be found to be in violation of the Proposed Regulation and potentially held criminally liable.

Criminalization of one officer’s act of certification upon the failure of a Regulated Institution to comply with prescribed standards is simply unsupportable as a legal matter when compliance is dependent on the actions of many individuals. Indeed, AML/CFT compliance is a firm-wide endeavor, dependent on the firms’ structure, risk assessment and risk-based design, as specified by the Bank Secrecy Act/Anti-Money Laundering Examination Manual issued by the Federal Financial Institutions Examination Council (“**FFIEC**”).<sup>4</sup> The manual states that “a banking organization has discretion as to how to structure and manage its BSA/AML compliance program,” and goes on to say that “[s]enior management is responsible for implementing the board-approved BSA/AML compliance program.”<sup>5</sup> In addition, the data that feeds into an institution’s Transaction Monitoring and Filtering Program generally comes from an institution’s business lines. Other parties, notably technology experts, also control critical parts of the monitoring and screening enterprise.<sup>6</sup> Finally, it is the institution’s other senior officers and directors, rather than the senior compliance officer, who control an institution’s budget and “tone from the top” culture of compliance that foster compliant AML/CFT programs. These officers

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<sup>4</sup> FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, 2014. Available at: [https://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2014\\_v2.pdf](https://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014_v2.pdf)

<sup>5</sup> See FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, 2014, “BSA/AML Compliance Program Structures: Overview,” pp. 155-160. In addition, the Federal Reserve Board’s Supervisory Guidance set forth in SR08-08 and FinCEN’s “Culture of Compliance” memorandum indicate that senior management is ultimately responsible for compliance.

<sup>6</sup> In addition, firms often purchase lists and outside systems to conduct various types of monitoring. If a certification requirement were imposed, the NYDFS should require that vendors certify that their systems and products are working according to specifications.

are also, in many cases, responsible for the resources of the Regulated Institutions that are dedicated to its Transaction Monitoring and Filtering Programs. For these reasons, shifting sole responsibility with the potential for civil or criminal liability to the senior compliance officer or any individual is fundamentally unfair, as so many individuals are responsible for compliance, and would encourage a mistaken notion that compliance is the sole responsibility of that individual, thus undermining the goal of creating a culture of compliance throughout the institution.

Further, the Proposed Regulation does not explicitly provide an “intent” standard for the imposition of criminal penalties. Rather, the proposed certification would require the signer to certify compliance with substantive and subjective requirements for AML transaction monitoring and watch list filtering programs. Additionally, the proposed certification could be read as asking for broad certification of banks’ AML/CFT compliance programs rather than solely the Transaction Monitoring and Filtering Programs. This is because the components of the Monitoring and Filtering program requirement incorporate references to, for example, know-your-customer due diligence provisions that, under the federal regulatory framework, apply to all aspects of a Regulated Institution’s AML/CFT compliance program, rather than to specific subsets of such programs.

The possibility of criminal liability will almost certainly have the counterproductive consequence of deterring talented and experienced individuals from seeking senior compliance officer positions at Regulated Institutions, thereby potentially harming the safety and soundness of those institutions and their ability to detect suspicious activity. An individual would be highly reluctant to take any position that is not merely career-threatening, but virtually life-threatening. Consider any individual who is contemplating two chief compliance officer positions – one at a Regulated Institution and the other at a national bank. Almost irrespective of a greater “reward” at the first, it will be outweighed by the attending greater “risk.”

Additionally, the proposed regulation does not provide an opportunity to indicate that during the course of a year an institution identified areas requiring improvement and either completed related remediation efforts (but had not validated the enhancements) prior to year-end or continues to pursue remediation efforts. In either event, the CCO or other certifying officer(s) could not certify compliance at that point in time.

Finally, certification would be difficult where a federal regulator has outstanding findings regarding a bank’s Transaction Monitoring and Filtering system. The compliance officer cannot disclose these findings because of their status as confidential supervisory information, yet would be required by the proposal to make the certification.<sup>7</sup>

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<sup>7</sup> See, e.g., 12 C.F.R. §261.20(d).

Therefore, we recommend that the proposed certification requirement for senior compliance officers with possible criminal penalties attached thereto be removed and that the NYDFS instead rely on the normal, robust prudential examination process to achieve assurance concerning the strength of Transaction Monitoring and Filtering Programs. The NYDFS' stated goal of the proposed certification requirement to enhance AML/CFT compliance could be achieved more effectively if the NYDFS were to adopt The Clearing House's recommendation and articulate its expectations in a supervisory policy without the proposed CCO certification, rather than by regulation, which would allow for those expectations to be reviewed as part of a Regulated Institution's BSA/AML internal audit program. Internal audit has long been considered and relied upon as part of the supervisory review process. Independent testing, which may be done internally by an institution, is one of the four pillars of an AML program and thus is subject to supervisory standards and expectations. This approach would help the NYDFS to achieve its goal of ensuring that Regulated Institutions have robust AML/CFT compliance programs. Further, if an employee of a Regulated Institution acts with the intent to deceive, the NYDFS has other avenues to address such action.<sup>8</sup>

**III. The proposal seeks to impose additional requirements on institutions in an area of law governed by a federal framework, resulting in duplicative and, in some cases, potentially conflicting expectations for covered institutions.**

The Clearing House believes that the proposal would impose requirements on institutions in an area that is already appropriately governed and fully occupied by a federal framework and could result in duplicative and, in some cases, potentially conflicting compliance expectations for Regulated Institutions. For example, as described further in Section IV of this letter, the proposal seeks to impose a requirement that Regulated Institutions' Transaction Monitoring Programs "reflect all current BSA/AML laws, regulations, and alerts, as well as any relevant information available 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." This requirement that such programs "reflect *all* current BSA/AML laws, regulations, and alerts" (emphasis added) could require banks to incorporate into their transaction monitoring programs BSA/AML laws that may not be relevant or appropriate based on the banks' risk assessments. By contrast, under the federal risk-based regime, banks have the flexibility to determine how best to incorporate applicable requirements into their monitoring systems.

As an initial matter, Congress entrusted the federal government with the responsibility to implement the Bank Secrecy Act and other measures designed to combat AML-related financial crimes and terrorist financing. In order to most effectively combat financial crimes and terrorism and maintain national security, it is critical that a uniform, national framework for combating

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<sup>8</sup> See, e.g., New York Banking Law Section 672.

such crimes be maintained. Indeed, federal agencies, in particular, FinCEN, in coordination with the federal bank regulators and working closely with law enforcement and national intelligence agencies,<sup>9</sup> have the expertise and access to the information necessary to design comprehensive and nationally consistent requirements and regulations to combat financial crimes and terrorist financing in the most informed and consistent manner. The introduction of state regulations governing areas covered by the federal BSA/AML/OFAC framework would likely result in disparate and contradictory requirements across the states and between the states and the federal government, which would thwart Congress's design of a uniform, national framework to combat financial crimes and terrorism.

The NYDFS Proposal would layer a state regulatory regime over a federal framework that currently applies consistent standards to both state-chartered and national banks and the U.S. branches and agencies of foreign banks. The federal regulatory regime is structured around the requirements of the BSA, as implemented by FinCEN and the federal bank regulatory agencies, which incorporates a risk-based approach as one of its fundamental premises, and therefore allows each bank to design its AML/CFT compliance program in a way that is calibrated to the specific risk profile of that firm. The introduction of state regulations governing areas covered by the federal BSA/AML/OFAC framework could potentially result in disparate requirements across the states and between the states and the federal government, thereby potentially weakening federal national security efforts in this regard.

Further, the federal risk-based regime allows banks to adapt to ever-changing threats, whereas the NYDFS proposal would create relatively static regulations that may not practically be amended quickly, thereby disadvantaging Regulated Institutions both competitively and operationally. Regulated Institutions would be subject to the static standards and regulations set forth in the proposal, in addition to the federal requirements, whereas functionally equivalent financial institutions not covered by the proposal (all national banks, state banks located outside of New York and federally-licensed branches and agencies of foreign banks, and all credit unions) would continue to be governed solely by the risk-based federal regime. This could result in:

- Less effective Transaction Monitoring and Filtering Programs at Regulated Institutions, as their ability to design and calibrate their Monitoring and Filtering systems in a flexible, risk-sensitive manner would be hindered by the proposal, as further explained in Section IV of this letter; and
- On a broader level, less effective compliance programs at Regulated Institutions, because they would not necessarily have the built-in flexibility to address the

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<sup>9</sup> See Former Treasury Under Secretary Cohen Testimony before the House Financial Services Committee, available at <https://www.treasury.gov/press-center/press-releases/Pages/j19697.aspx> (Nov. 13, 2014).

dynamic aspects of the AML and terrorist financing threat, as described in Section V of this letter.

Thus, as indicated above, The Clearing House respectfully suggests that, as an alternative to adoption of the proposal, the NYDFS instead pursue its stated policy goals through enhanced public/private sector dialogue through the establishment of a task force and more specific supervisory focus on Transaction Monitoring and Filtering practices. We believe that the objectives of the proposal would be served more effectively if the NYDFS were to articulate its expectations in a supervisory policy without the certification requirement, rather than by regulation, and that those expectations be reviewed as part of Regulated Institutions' BSA internal audit programs. This approach would help the NYDFS to achieve its goal of ensuring that Regulated Institutions have robust BSA/AML/OFAC Transaction Monitoring and Filtering Programs while avoiding the likely counterproductive effects of the proposed certification requirement. If the NYDFS instead proceeds with prescribing requirements in this area, The Clearing House respectfully requests that the NYDFS amend the proposal, as described below.

**IV. The proposal seeks to impose additional Transaction Monitoring and Filtering requirements on Regulated Institutions that are, in some instances, redundant with existing expectations and practices, and in other instances unclear, inflexible, and potentially overly broad in scope.**

The Clearing House has significant concerns that the proposal is duplicative of existing federal expectations and current practices of Regulated Institutions and at the same time is overly general and vague in nature, creating unclear expectations and an un-level playing field between Regulated Institutions and those not subject to the proposal. In addition, the proposed requirements could be subject to varying interpretations by different examiners, potentially creating an un-level playing field *among* covered institutions, as well as different criminal and civil standards against which institutions and individuals will be held by federal regulators, as explained in further detail below.

As an initial matter, the proposal appears to attempt to codify the FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual,<sup>10</sup> which is hundreds of pages long, into a very brief, 2-page regulation. This attempt to codify federal guidance by a single state is unnecessary and could create inconsistencies between federal and state interpretations and thus lead to confusion as to the requirements of federal law. Furthermore, the proposal appears to mirror recent consent orders (e.g., *In re Commerzbank AG*, FRB Cease & Desist Order No. 15-001 (Mar. 12, 2015); *In the Matter of BNP Paribas, S.A. New York Branch*, DFS Consent Order (June 29, 2014); *In re Citibank, N.A.*, OCC Consent Order No. 2012-052 (Apr. 5, 2012); *In re*

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<sup>10</sup> FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, 2014. Available at: [https://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2014\\_v2.pdf](https://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014_v2.pdf)

*Ocean Bank*, FinCEN Assessment of Civil Money Penalty No. 2011-7 (Aug. 22, 2011)), which are not intended to be generally applicable in the same way as a regulation.

#### **A. Concerns regarding Section 504.2**

Section 504.2 provides definitions for the terms used in the proposal, including a definition for the term “Bank Regulated Institutions,” which are those entities that are subject to the proposal. The term “Bank Regulated Institutions” is defined as “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 pursuant to the Banking Law to conduct banking operations in New York.” Consistent with the authority of the NYDFS over State-licensed branches and agencies of foreign banking corporations, TCH recommends that the definition of “Bank Regulated Institution” be clarified to reflect that the proposal only applies to activities conducted at the licensed branch or agency. This would clarify that where transaction monitoring and screening are conducted at other U.S. offices of the foreign bank or U.S. offices of another entity, the requirements of the proposal would only apply where the transaction monitoring and screening conducted at such offices relates to activities of the licensed branch or agency.

With respect to the definition set forth in section 504.2(i) of “Watch List Filtering Program,” which refers to section 504.3(b), discussed further below, The Clearing House recommends replacing the term “Watch List” with a reference to OFAC specially designated nationals and blocked persons lists as well as country-based sanctions lists, as “Watch List” refers to lists developed by law enforcement and/or border control agencies to identify persons of interest for surveillance, detention or other action. For example, the federal government uses the term “Terrorist Watch List” to refer to a non-public list maintained by the Terrorist Screening Center administered by the FBI, and the term “No-Fly-List,” which is a subset of the Terrorist Watch List, to refer to a list of individuals who are prohibited from boarding aircraft. These lists are fundamentally different from the OFAC economic sanctions lists that carry specific obligations and prohibitions related to the property of a listed party and/or potential dealings with a listed party. It should be noted that OFAC expressly does not refer to its lists as “Watch Lists.” We also suggest replacing the word “filtering” with “screening” to comport with the terminology used in the FFIEC Manual.

#### **B. Concerns regarding Section 504.3(a)**

First, the proposed requirements set forth in this section that would require a Regulated Institution’s Transaction Monitoring Program to “reflect all current BSA/AML laws, regulations and alerts, as well as any relevant information from the institution’s related programs and initiatives,” are unnecessary because, in certain respects, they are broadly reflective of existing law, regulation, and guidance, or are generally implemented by banks in their AML/CFT programs currently. For example, the requirements proposed in Sections 504.3(a)1 through 4

appear to be variations on the existing federal guidance that AML processes should be risk-based. Thus, The Clearing House believes that the proposed requirements in this section are unnecessary and could be contradictory to existing federal regulations and guidance, as discussed in more detail in this letter, as the federal BSA/AML risk-based approach may not always require application of “all current BSA/AML laws, regulations and alerts.”

Further, while the proposed requirements appear to broadly reflect existing federal expectations and current industry practice in some regards, in other respects, The Clearing House is concerned that they are conceptually imprecise and overly broad. For example, the proposal would require 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, such as ‘know your customer due diligence’, ‘enhanced customer due diligence’ or other relevant areas, such as security, investigations, and fraud prevention.” This proposed requirement is exceedingly broad and extends well beyond current expectations and industry practice under the federal risk-based framework. First, the reference to an institution’s “security, investigations, and fraud prevention” is vague and, as drafted, does not appear to have any clear nexus to AML/CFT efforts. Therefore, it is unclear how this information would be relevant to or incorporated into a Regulated Institution’s Transaction Monitoring Program. In addition, the reference to “all current BSA/AML laws, regulations, and alerts” is overly broad. Indeed, not all BSA/AML laws, regulations, or alerts are necessary or appropriate for incorporation into Transaction Monitoring Programs. Further, under the federal risk-based regime, banks have the flexibility to determine how to incorporate applicable laws and information into their BSA compliance programs, which may include incorporation into Transaction Monitoring and Filtering Programs based on the bank’s risk assessment.<sup>11</sup>

In addition, as written, the proposed requirements could be interpreted to cover all relevant information from know-your-customer records in generating alerts, rather than simply using portions of this information in the development of traditional monitoring scenarios, which is current practice. Finally, there are many other concepts and terms that are vague as used in the proposed requirements in this section. For example, the term “alert” is susceptible to a variety of interpretations, some of which may be overly broad. Indeed, an “alert” is sometimes confused with “escalation.” Further, the proposal does not account for the fact that the determination of the relevance and relative significance to each institution of an “alert” or “relevant information” is a risk-based function dependent on many factors, such as, for example, the institution’s size, complexity, and the reliability of the source, in addition to other information the institution may

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<sup>11</sup> Many laws promulgated under the BSA would not be relevant for transaction monitoring purposes, such as Sections 312, 313, and 319 of the PATRIOT ACT, which include requirements to maintain certain records, reports, and due diligence programs for foreign correspondent accounts and prohibitions on accounts with foreign shell banks.

have that either confirms or challenges the accuracy of that information. Because information that may be “relevant” to one institution may not always be relevant to another, Regulated Institutions should have the flexibility to make their own determinations as to what constitutes an “alert” or “relevant information,” consistent with the federal risk-based framework. For example, FinCEN has issued a number of advisories related to correspondent banking (reflecting Financial Action Task Force designations) and transactions involving Mexico. For a small bank that does not engage in such transactions, it does not make sense to build out a formal monitoring program to address these alerts. However, the plain language of the proposal states that a Regulated Institution’s Transaction Monitoring Program must “reflect . . . all alerts.” However, if “alert” and other terms are left undefined, they could be interpreted by examiners in an overly broad manner, which could negatively impact a Regulated Institution’s ability to manage its Transaction Monitoring and Filtering Programs according to the bank’s risk assessment.

By restating existing federal standards, many of which are set forth in detail in the FFIEC’s several-hundred-page examination manual, with vague or imprecise language, the NYDFS would only create confusion with no attendant benefit to law enforcement, which would be the ultimate beneficiary of this program. Such lack of clarity could have a deleterious effect on bank compliance programs, as it could result in banks expending resources to meet this overly broad standard, with little idea of how the standard would be interpreted in practice by NYDFS supervisory or examination staff, rather than focusing resources on a more appropriately calibrated risk-based compliance program.

Another related concern is that compliance professionals at Regulated Institutions discharging their responsibilities in good faith are best positioned to make the necessary risk-based judgments about the information they employ to sustain and improve the efficacy of the programs they administer. Requiring that *all* alerts and potentially relevant information must somehow be accommodated in administering a BSA/AML and OFAC-compliant program will exacerbate the risk that some agency personnel will retrospectively substitute their risk-based assessments for those of the professionals charged with doing so on a real-time basis, in addition to diffusing Regulated Institutions’ resources. This could lead those professionals to act in ways that will result in overinclusive alerting functionality that will produce more alerts with little value, thus diverting available investigative assets, and potentially result in less effective identification of transactions having substantive BSA/AML/OFAC noncompliance elements, which would thwart the intended outcome of the NYDFS’ proposal.

If the NYDFS were to proceed with establishing our proposed stakeholder task force on these matters, this entity could serve as a conduit through which regulatory expectations around Transaction Monitoring and Filtering Programs could be communicated and further discussed. If, nonetheless, the NYDFS proceeds with prescribing requirements in this area, TCH respectfully requests that the NYDFS significantly scale back its overly broad proposed requirements in this section. In particular, TCH urges the NYDFS to remove the requirement that Regulated Institutions’ Transaction Monitoring Programs “reflect all current BSA/AML

laws, regulations, and alerts, as well as any relevant information available 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." Instead, TCH suggests that the NYDFS amend the language in section 504.3(a)(2) to require Regulated Institutions to "review and periodically update at risk-based intervals" their transaction monitoring systems to take into account "changes to applicable BSA/AML laws and regulations, as well as other relevant information that comes to the attention of the Regulated Institutions." This change, coupled with the elements of a risk-based approach – application of relevant rules, use of risk assessments and periodic incorporation of updates – would reflect the risk-based nature of the system and provide Regulated Institutions with flexibility as to what information to incorporate into their systems and how frequently to incorporate that information.

At a minimum, TCH believes that Regulated Institutions would benefit from further clarity regarding the NYDFS' expectations as to (i) what "BSA/AML laws, regulations, and alerts" and information from "other relevant areas" should be "reflected" in Regulated Institutions' Transaction Monitoring Programs and in what manner and (ii) what information should be taken into consideration from the "know your customer due diligence" and "enhanced due diligence and fraud prevention programs" and how it should be "reflected" in Regulated Institutions' Transaction Monitoring Programs. TCH also recommends that the NYDFS adopt the definitions that federal BSA/AML/OFAC authorities have adopted with respect to the same or similar terms used in the proposal. An example of this would be the definition of the term "transaction" that is defined in 31 C.F.R. §1010.100(bbb).

Finally, there is a timing problem with the proposed requirements in this section, as the proposal does not provide for the necessary lag time between the time when new or updated regulatory matters (such as a new regulation or alert) become available and the time when that information can be incorporated into a sophisticated transaction monitoring system. Once such information comes to the attention of a Regulated Institution, the institution must first determine whether and how that information will affect the system, then determine how to program the system to account for the new information, then write the program and test it, then train personnel and change broader procedures, and finally implement the new programming in the system, which often takes many months or longer if new or substantially upgraded automation is required to be properly designed and rules are required to be set before implementing. Thus, The Clearing House recommends that the NYDFS clarify that Regulated Institutions will be afforded a reasonable time frame to incorporate any new regulatory matters into their transaction monitoring systems, taking into account the size and complexity of the institution and the changes that must be made.

### **C. Concerns regarding Section 504.3(b)**

The Clearing House also has concerns regarding the proposed requirements set forth in Section 504.3(b), which would mandate that Regulated Institutions maintain a Watch List

Filtering Program “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.” The requirements proposed in this section appear to mandate measures regarding Monitoring and Filtering programs that are effectively governed by the FFIEC Examination Manual and the federal examination process. The Clearing House therefore respectfully requests that this section not be adopted. As noted above, if the NYDFS were to proceed with establishing a stakeholder task force on these matters, this entity could serve as a conduit through which regulatory expectations around Transaction Monitoring and Filtering Programs could be communicated and further discussed.

If the NYDFS proceeds with prescribing requirements in this area, The Clearing House recommends that NYDFS modify this section of the proposal as follows. First, as drafted, the proposed requirements in this section could be interpreted as requiring banks to screen or filter *all* transactions against the identified types of lists, which is exceedingly broad and contrary to current OFAC expectations that banks utilize a risk-based approach to transaction monitoring.<sup>12</sup> Therefore, TCH recommends that the NYDFS make clear that banks would not be required to screen or filter *all* transactions against the identified types of lists. One way in which this clarification could be achieved would be for the NYDFS to revise the language in footnote 4 of the proposal to read “[T]he system or technology used must be reasonably designed to capture prohibited transactions,” as opposed to all transactions, as the language currently implies. No system or technology can guarantee that it will capture all prohibited transactions.

Additionally, the requirements in this section also create an unclear standard against which banks would be measured, leaving banks subject to examiners’ interpretations of what is required under this new proposed mandate, as neither “other sanctions lists” nor “internal watch lists” is defined. Indeed, the term “internal watch list” is ambiguous, as financial institutions maintain an array of internal lists for various reasons, many of which would not necessitate real-time transactional screening. Further, the proposal provides no guidance around how these internal watch lists should be developed or on what basis a person can or should be placed on a watch list such that the bank refuses to process transactions involving that person. This could unfairly deny individuals access to banking services and will likely increase banks’ exposure to claims for financial damages alleging processing delays. In addition, the proposal’s use of the term “other sanctions list” is confusing, as international lists could be covered under this definition. It would not be appropriate for the NYDFS to attempt to enforce non-U.S. sanctions programs. Therefore, the proposal should specify that it applies to only U.S. OFAC sanctions lists.

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<sup>12</sup> See, e.g., FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, 2014, “Office of Foreign Asset Control: Overview,” pp. 142-154.

The Clearing House urges the NYDFS to amend these proposed requirements to remove any mandate to screen anything other than OFAC specially designated nationals and blocked persons lists as well as country-based sanctions lists in real-time and to clarify the standard against which banks will be measured, while allowing banks the flexibility to build and employ Transaction Monitoring and Filtering Programs based on their own assessments of customer risk, consistent with the federally-mandated risk-based compliance approach.

We note that the version of the proposal first published on the NYDFS' website would have required Regulated Institutions to maintain a Watch List Filtering Program "for the purpose of interdicting transactions, before their execution, that are prohibited by applicable sanctions, including OFAC and other sanctions lists, *politically exposed persons lists*, and internal watch lists" (emphasis added). The official version of the proposal published in the New York State Register on December 16, 2015, does not include the reference to "politically exposed persons lists" ("**PEPs**") in the proposed rule text, but it does include a statement in the preamble that "[t]he Department believes that other financial institutions may also have shortcomings in their transaction monitoring programs for monitoring transactions for suspicious activities, and watch list 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." We support the removal of the reference to PEPs from the proposed Watch List Filtering Program requirements, and from the entirety of the proposal for the following reasons.

There is no federal requirement to interdict payments of PEPs, and a requirement to screen transactions in real-time for PEPs could have significant consequences for individual financial institutions as well as the financial system as a whole. The universe of potential PEPs is many times larger than the number of parties subject to sanctions (which, as a general matter, consists of parties expressly designated by governmental authorities, as well as, certain parastatals and their majority-owned subsidiaries). Indeed, the term "PEP" is flexible and can encompass potentially millions of U.S. and foreign government officials at the national as well as state, provincial, and municipal levels. Real-time transaction screening of such a large number of names, many of which will be common and lack actionable identifier information to facilitate ready disposition, would overwhelm the screening capabilities of financial institutions and thus have significant industry impacts. The associated operational demands would also shift resources away from higher-risk sanctions screening activities. As transacting with PEPs is not prohibited under the federal BSA/AML/OFAC framework, it is unclear whether it is the intent of the NYDFS to prohibit transactions with such individuals. Further, federal legislation requires firms to apply Enhanced Due Diligence ("**EDD**") for customers with a private bank account who are identified as having political exposure. With respect to transactions from third parties, EDD would be unachievable as financial institutions would rarely have or be able to obtain, the additional identifying information to determine whether someone was, in fact, a PEP. Further, this provision could be interpreted to require Regulated Institutions to stop these transactions

before processing. Under federal guidance, the purpose of identifying PEPs is to monitor for possible official corruption risk. This is done through a combination of EDD and post-transaction monitoring. There is no requirement under federal law that transactions with PEPs be interdicted in real-time and rejected. In addition, because, as of today, there is no legal requirement or even law enforcement intent to stop transactions originating from or benefitting PEPs, implementing such a prohibition could place financial institutions in conflict with local laws in certain jurisdictions.

Therefore, The Clearing House strongly urges the NYDFS to remove any requirement to screen transactions for PEPs in real-time from any final rule.

**V. While TCH understands the NYDFS’s concerns around Transaction Monitoring and Filtering Program alterations and changes, we recommend that the NYDFS refine Section 504.3(d) so as not to prohibit the legitimate and critically important ability of banks to make adjustments to their filtering systems.**

The Clearing House also has serious concerns with the possible consequences of the proposed prohibition set forth in Section 504.3(d) that would forbid Regulated Institutions from making changes or alterations to their Transaction Monitoring and Filtering Programs “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 under the proposal, or to otherwise avoid complying with regulatory requirements.” Our concern with this provision is the broad reference to “avoid or minimize filing suspicious activity reports.” Federal authorities, including law enforcement and intelligence agencies, encourage banks to adjust their systems on a risk-focused basis so that they are not overwhelmed by unhelpful SAR filings. In contrast, Section 504.3(d) is likely to encourage such filings.

We understand that this requirement is intended to address NYDFS concerns that institutions may be adjusting the sensitivity of filters to reduce the number of alerts generated based on concerns about the availability of resources to clear the alerts, thereby allowing suspicious transactions to remain undetected. However, we believe that this proposed prohibition is overly broad for the purposes of addressing such concerns and would inappropriately prohibit the important adjustments that banks must necessarily make as part of a risk-based AML/CFT program in order to identify transactions and information that will be useful to law enforcement and to avoid capturing too many transactions such that it is difficult to detect suspicious activity or other crimes. The ongoing optimization of filter parameters is an appropriate and standard industry practice and a cornerstone of a risk-based sanctions screening approach. Indeed, as part of a risk-based compliance program designed to detect suspicious activities in order to provide useful information to law enforcement rather than to review every transaction flowing through the institution, it is important for financial institutions to have the flexibility to adjust their Transaction Monitoring and Filtering Program scenarios to detect

AML/CFT risks, including the ability to adjust their scenarios in advance of new or changing products, services and activities of the Regulated Institution.

The minimization of false positives, which divert resources from the review of higher risk transactions, is a key objective of these optimization efforts, and the opportunity costs associated with over-detection create real compliance risk. For example, if an institution is monitoring for potential structuring and pulls alerts for customers engaging in transactions over a certain dollar threshold (e.g. \$2500), as the institution grows, there will likely be an increase in the volume of false positives, netting only a handful of potential investigations and useful SAR filings at that particular threshold. However, if the institution were to increase its transaction alert threshold (e.g. to \$3500), the number of false positives would likely decrease. While this could lead to a de minimis reduction in the number of total SARs filed, at a higher threshold, the institution may have a sufficient volume of alerts to develop a scenario to identify and better track funnel accounts and as a result, file SARs that will better assist law enforcement in combating financial crimes and terrorism. This example illustrates the importance of a flexible risk-based system that allows Regulated Institutions to adjust their alerts and scenarios to maximize their ability to detect AML/CFT risks. If banks cannot make appropriate risk-based adjustments to their scenarios, there is a danger that such a prohibition could (i) reduce institutions' ability to detect suspicious activity, as such transactions may simply get lost in the sheer volume of transactions that banks would have to review absent the ability to adjust their scenarios on a risk-focused basis, and (ii) lead to the over-filing of SARs that do not meet the filing threshold under federal law as a result of banks' being overwhelmed by the volume of transactions they would have to review and thus simply filing out of an abundance of caution. This so-called "defensive filing" would not be helpful to law enforcement efforts. Indeed, based on conversations with law enforcement officials, it is our understanding that the over-filing of SARs can in fact be detrimental to law enforcement efforts and thus is a shared concern of both industry and law enforcement. Further, if Regulated Institutions do not make changes to their Transaction Monitoring and Filtering systems in order to comply with the proposed prohibition on changing or altering those systems, they could be subject to criticism from their federal BSA/AML regulators and examiners, who expect banks to adjust their systems on an ongoing basis in response to changes in criminal behavior and other emerging risks.

In addition, this prohibition could also chill innovation in Transaction Monitoring and Filtering systems by discouraging compliance officers from attempting to change and improve their systems. Additionally, we are concerned that banks' use of this important tool to maximize their ability to detect actual suspicious transactions will be misinterpreted by supervisors and examiners as being done in order to shirk reporting or other compliance obligations or because of staffing concerns. For example, the proposal could be interpreted to prohibit the modification of scenarios in response to their output quality. Yet, such a prohibition appears to contradict the federal FFIEC manual, which states that "[m]anagement should periodically evaluate the

appropriateness of filtering criteria and thresholds used in the monitoring process.”<sup>13</sup> In addition, the exam manual stipulates that “[e]xaminers should focus on whether the bank has an effective SAR decision-making process, not individual SAR decisions,” yet the NYDFS proposal appears to require their examiners to do the latter. Therefore, we recommend that if the NYDFS proceeds with imposing requirements in this area, that this requirement be removed or, if not removed, amended to clarify that routine optimization and false hit reduction efforts will not run afoul of this provision, and that only changes or alterations to a Regulated Institution’s Transaction Monitoring or Filtering Program made with the *intent* to “avoid complying with regulatory requirements” will be prohibited. While TCH understands and shares the NYDFS’ concerns around the intentional or reckless disregard of alerts and the intentional suppression of alerts, the potential costs of the overly broad requirements in this section outweigh the regulatory and law enforcement benefits of a risk-based approach that allows the legitimate and critically important ability of banks to make adjustments to their monitoring and filtering systems.

## **VI. Concerns with the effective date**

The Clearing House member banks have concerns with the proposal’s implementation timeline, as it states that the regulation will be effective immediately and apply beginning with the Fiscal Year beginning on April 1, 2017. This may be too soon for some institutions to implement the proposed changes. As described throughout this letter, if the proposal is promulgated as currently drafted, there would be many aspects of the requirements with respect to which Regulated Institutions likely would seek clarity from the NYDFS before implementing those requirements. This process could necessitate several months of consultation with the NYDFS. The proposal also will likely require Regulated Institutions to invest significant resources – including personnel, technology and funding – to properly adhere to the proposal’s requirements, which will take many months to structure and implement. In addition, these changes will need to be in place before a Regulated Institution’s Transaction Monitoring and Filtering Program can be adequately certified, if such a certification requirement is implemented. Further, if pre-implementation testing is required, but existing systems are not grandfathered, additional time will be required to fully implement the proposal. Therefore, we respectfully request that the NYDFS allow Regulated Institutions a reasonable period of time to comply with the proposal.

## **VII. Concerns with the Regulatory Impact Statement and the Regulatory Flexibility Analysis**

As described throughout this letter, the proposal will have a substantial impact on the Transaction Monitoring and Watch List Filtering Programs of Regulated Institutions, which,

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<sup>13</sup> See, FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, 2014, “Suspicious Activity Reporting: Overview,” pp. 60-75.

coupled with the additional certification burden, will create significant additional compliance costs and administrative burdens. Therefore, we recommend that the NYDFS re-evaluate its estimation that under the current proposal such costs and burdens will be minimal and instead modify the proposal to account for the significant costs and burdens this proposal will impose on Regulated Institutions.

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The Clearing House appreciates the opportunity to comment on this proposal and would welcome the opportunity to provide you with any assistance or input that you might find helpful. Should you have any questions or need further information about any of the matters discussed in this letter, please do not hesitate to contact me at [paige.pidano@theclearinghouse.org](mailto:paige.pidano@theclearinghouse.org) or (202) 649-4619.

Respectfully submitted,



Paige E. Pidano  
Managing Director, Senior Associate General Counsel  
The Clearing House Association L.L.C.

cc:

Board of Governors of the Federal Reserve System

Michael Gibson  
*Director, Division of Banking Supervision and Regulation*

Michael Solomon  
*Associate Director, Division of Banking Supervision and Regulation*

Suzanne Williams  
*Associate Director, Division of Banking Supervision and Regulation*

Koko Ives  
*Manager, Bank Secrecy Act / Anti-Money Laundering Section*

Scott Alvarez  
*General Counsel*

U.S. Department of the Treasury

Adam J. Szubin  
*Acting Under Secretary for Terrorism and Financial Intelligence*

Daniel L. Glaser  
*Assistant Secretary for Terrorist Financing*

Sarah K. Runge  
*Director of the Office of Strategic Policy for Terrorist Financing and Financial Crimes*

Jennifer Shasky Calvery  
*Director, Financial Crimes Enforcement Network*

Jamal L. El-Hindi  
*Deputy Director, Financial Crimes Enforcement Network*

Office of the Comptroller of the Currency

Martin Pfinsgraff  
*Senior Deputy Comptroller for Large Bank Supervision*

Jennifer C. Kelly  
*Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner*

Grovetta Gardineer  
*Senior Deputy Comptroller for Compliance and Community Affairs*

Amy Friend  
*Senior Deputy Comptroller and Chief Counsel*

Daniel P. Stipano  
*Deputy Chief Counsel*

Federal Deposit Insurance Corporation

Doreen Eberley  
*Director, Division of Risk Management Supervision*

Lisa Arquette  
*Associate Director, Division of Risk Management Supervision*

Charles Yi  
*General Counsel*