MORRISON | FOERSTER

Legal Updates & News

Legal Updates

The New SWIFT MT 202 COV: More Transparency and Information for Cross-Border Funds Transfers

January 2010

Related Practices:

- Financial Services Law

Summary

On December 17, 2009, the U.S. federal banking supervisors[1], in consultation with the Office of Foreign Assets Control (OFAC) and the Financial Crimes Enforcement Network (FinCEN), issued an interagency guidance that sheds some light on the U.S. regulators' view about the use of the new SWIFT MT 202 COV messages and discusses the supervisors' approach to reviewing an institution's risk management practices with respect to cross-border funds transfers.

The Basel Committee on Banking Supervision published a paper in May 2009 addressing transparency issues regarding cross-border cover payment messages (BIS Paper).[2] The BIS Paper discusses the risks inherent in cover payment arrangements because of the lack of transparency and clarifies the supervisory expectations about what information must be made available to cover intermediary banks that process cover payments after the adoption of the new messaging standards. On November 21, 2009, SWIFT implemented a new MT 202 COV message that contains additional information about the originator and the beneficiary for any bank-to-bank transfer that is a cover payment and should enable banks to successfully perform the necessary sanctions screening and suspicious activity monitoring.

The interagency guidance clarifies the U.S. banking regulators' perspectives on certain points in the BIS Paper, including the expectations on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) sanctions screening and suspicious activity monitoring by cover intermediary banks. However, the interagency guidance does not create new obligations for any institution beyond what is required by applicable laws and regulations.

Cover Payments

The processing of cross-border wire transfers often involves several financial institutions, particularly when funds are transferred from a customer to a beneficiary in a foreign country or when a foreign currency is involved and the originator's bank does not have a relationship with the beneficiary's bank. The originator's bank may directly instruct the beneficiary's bank to effect the payment and advise that the transmission of the funds to "cover" the interbank obligation, which was created by the payment order, has been arranged through a separate channel. The settlement of the interbank obligation will then be accomplished through the originator's cover intermediary bank, a correspondent bank in the beneficiary's country. If the cover intermediary bank does not have a relationship with the beneficiary's bank either, a second cover intermediary bank will have to get involved. Unlike a transaction where there is a direct sequential chain of payments and the information travels together with the funds from bank to bank, the cover intermediary bank did not receive the same information as the beneficiary's bank about the originator or the beneficiary of the transaction. As discussed below, the new SWIFT message format MT 202 COV will correct this.

The cover payment mechanism is used to avoid the delays associated with different time zones between the originator's bank and the beneficiary's bank and to reduce costs of commercial transactions. The advantage for both the customer and the beneficiary is that the amount can be credited to the beneficiary's account even before the interbank settlement is completed.

The New SWIFT MT 202 COV Message Format

In the past, SWIFT message formats used two different message streams, the MT 103 from the originator's bank directly to the beneficiary's bank and the MT 202, a bank-to-bank payment order from the originator's bank to the cover intermediary bank, which did not contain the same information about the originator or the beneficiary of the transaction. The new MT 202 COV message format contains mandatory, standardized originator and beneficiary data fields with the objective of enhancing transparency in payment messages and enabling the cover intermediary bank to perform the appropriate AML/CFT sanctions screening and suspicious activity monitoring.

For all transactions for which there is an associated MT 103, the MT 202 COV is now mandatory and must be used, regardless whether the payments represent cross-border transactions. The new MT 202 COV contains fields for originator and beneficiary information and U.S. originator's banks' procedures must address the appropriate use of the new message format.

Sanctions Screening, Blank Fields, and Suspicious Activity Monitoring by U.S. Cover Intermediary Banks

The new MT 202 COV format does not change U.S. AML/CFT sanctions obligations but increases the amount of information available to be screened. To comply with applicable law, U.S. cover intermediary banks conduct monitoring of funds transfers that are processed through their automated systems to identify suspicious activity on a risk-based approach. This monitoring may be conducted on an automated basis after the transfers are processed, similar to the monitoring in place for MT 103 payments. If a MT 202 COV contains a blank field, SWIFT will automatically reject the message and the cover intermediary bank will not receive any payment instruction. However, cover intermediary banks are required to monitor payment message data for manifestly meaningless or incomplete fields, *i.e.*, where it is obvious that the MT 202 COV message does not identify parties to a transaction. The interagency guidance states that a U.S. cover intermediary bank is not required to manually review every payment order but that such bank must have a risk-based method to identify incomplete fields or fields with meaningless data. The BIS Paper suggests appropriate responses if a cover intermediary bank receives a MT 202 COV message containing manifestly meaningless or incomplete fields, which include (i) contacting the originator's bank in order to clarify or complete the information received, (ii) considering whether the correspondent banking relationship should be restricted or terminated, and/or (iii) filing a suspicious activity report with the local authority, in the case of a U.S. bank with FinCEN.

U.S. cover intermediary banks should factor into their risk assessment their correspondent banks' policies and practices of sending messages without utilizing the new MT 202 COV where available, and should have appropriate controls in place if a correspondent bank does not use the new message format. The interagency guidance emphasizes that U.S. banks should strongly encourage their correspondent banks to observe the new standards and to use the MT 202 COV in cover payment transactions.

Supervisory Approach

Supervisors will continue to review U.S. banks' correspondent banking practices to ensure that the banks have appropriate internal controls in place to monitor wire transfer activity, that these controls are effective, and that the banks comply with the applicable regulatory guidance. In particular, examiners will focus on:

1. Reviewing whether the institution has current Bank Secrecy Act/Anti-Money Laundering and OFAC risk assessments that address payments operations and take into consideration all relevant factors, including correspondent banking relationships, volume and jurisdictions of funds transfers, and the role of the institution in funds transfers (*i.e.*, whether it is the originator's bank, intermediary bank or beneficiary's bank).

2. Determining whether the institution has implemented transparency standards for international funds transfers and maintains systems for consistent adherence to standards; examiners should also be satisfied that originators' banks include complete customer information in cross-border funds transfers.

3. Evaluating whether the institution has processes for conducting adequate due diligence on foreign correspondent banks, as required under section 312 of the USA PATRIOT Act and corresponding regulations.

Links

The following are the links to the interagency guidance, as published by the Federal Reserve, and to the BIS Paper:

http://federalreserve.gov/boarddocs/srletters/2009/sr0909a1.pdf

http://www.bis.org/publ/bcbs154.pdf?noframes=1

If you have any questions pertaining to this alert, please feel free to contact Barbara R. Mendelson at (212) 468-8118, Oliver I. Ireland at (202) 778-1614, Mark T. Gillett at (213) 892-5289, Aki Bayz at (202) 887-8796, or Marc-Alain Galeazzi at (212) 336-4153.

Footnotes

[1] The U.S. federal banking supervisors are (i) the Board of Governors of the Federal Reserve System, (ii) the Federal Deposit Insurance Corporation, (iii) the National Credit Union Administration, (iv) the Office of the Comptroller of the Currency, and (v) the Office of Thrift Supervision.

[2] Basel Committee on Banking Supervision, *Due Diligence and transparency regarding cover payment messages related to cross-border wire transfers*, May 2009.