



The Wolfsberg Group and the Clearing House Association LLC

Cover Payments: Some Practical Questions Regarding the Implementation of the New Payments Messages

To enhance transparency in the payment system, new payment messages have been developed by SWIFT, the MT 202 COV and the MT 205 COV (what is noted below with regard to the MT 202 and MT 202 COV also applies to the MT 205 and MT 205 COV, and the discussion hereafter will not separately reference the MT 205 and MT 205 COV). The new payment messages are part of the SWIFT release that will become available November 21, 2009. These new payment messages will provide for the replication of all information contained in certain fields of the MT 103. The way in which these new payment messages should be used is addressed in *Due diligence and transparency regarding cover payment messages related to cross-border wire transfers*, issued by the Basel Committee on Banking Supervision in May 2009 (the "Basel Paper").¹

Starting November 21, 2009, the MT 202 COV, in keeping with the Basel Paper and the SWIFT Handbook (see SWIFT Press Release, *New Standards for Cover Payments*, May 19, 2009, available at http://www.swift.com/about_swift/press_room/swift_news_archive/home_page_stories_archive_2009/Newstandardsforcoverpayments.page?) is to be used for cover payments (in all currencies and jurisdictions), and, starting on that date, the MT 202 is no longer to be used for cover payments.

Financial institutions are in the process of preparing for these changes, and questions have arisen regarding the roles of originators' banks and intermediary banks with regard to the use of these new payment messages. The following Questions and Answers are intended to enhance understanding of the implications of these changes.

¹ <http://www.bis.org/publ/bcbs154.htm>.

1. What should the role of originators' banks be regarding the use of payment message formats?

The fundamental understanding regarding the use of the MT 202 COV has always been based on the principle that originators' banks are the starting point in the payment message chain and that it is they that determine whether the MT 202 or MT 202 COV is to be used. Accordingly, it is key to the success of this initiative to promote transparency that originators' banks use the appropriate payment message formats.

It is also essential that originators' banks do not include incomplete or meaningless originator or beneficiary data in MT 202 COV payment messages.

2. What should the role of an intermediary bank be regarding the use by originators' banks of the incorrect payment message format?

Intermediary banks are not in a position to ensure that their correspondents, acting as originators' banks, use the appropriate message format. However, if the intermediary bank in the normal course of risk-based monitoring becomes aware that an originator's bank is purposely using the wrong message type to avoid detection of information by any other financial institution in the payment process, the intermediary bank should take appropriate steps.

A. What intermediary banks should do generally:

- Intermediary banks should screen the information they receive in payment messages in accordance with their screening frameworks. Such information includes the new information that would become available by virtue of the MT 202 COV.
- Intermediary banks should monitor payment messages for unusual or potentially suspicious activity on a risk-focused post-transaction basis. Such monitoring would take into account the new information that would become available by virtue of the MT 202 COV.
- Intermediary banks need not review each incoming MT 202 and MT 202 COV payment message to determine whether the originators' banks are using the proper payment messages.

B. What an intermediary bank should do if it becomes aware that an originator's bank is using the incorrect payment message format:

It is premature at this early stage to set forth the steps to be taken in the event that an intermediary bank becomes aware that an originator's bank is not using the correct message format. Use of the incorrect message format is not in itself necessarily suspicious and may simply be due to operational circumstances or misunderstandings.

Over time, as the use of the new message format becomes more settled, an intermediary bank may, using a risk-based approach, consider making appropriate inquiries of correspondents that use MT 202s in transactions in which the intermediary knows that the correspondent bank should use MT 202 COVs.

3. What should the role of an intermediary bank be in determining whether data fields in the MT 202 COV include manifestly incomplete or meaningless information?

Intermediary bank computer programs cannot be designed to make these determinations on an automated, large scale straight-through processing basis; such determinations are subjective and can

only be made when there is manual (i.e. human) intervention in the review process. Such determinations involving manual intervention cannot be made on a “real time” basis. Even when there is manual intervention, it may not be possible for an intermediary to make such determinations unless the incompleteness or meaninglessness is manifest to the reviewer on the basis of what he or she knows; intermediary banks have no relationship with the originator or beneficiary and therefore have little factual context in which to make such determinations.

As part of monitoring their correspondent relationships, intermediary banks should have policies for monitoring payment data subsequent to processing transactions. Such policies and procedures should, using a risk-based approach, address the alerting of unusual activity, including circumstances in which there is something sufficiently unusual about a transaction or a series of transactions so as to trigger the need to consider a suspicious activity report.

While intermediary banks need not verify that originator and beneficiary information contained in each MT 202 COV is meaningful and complete, if in the course of a subsequent manual review it comes to the attention of the reviewer that there are manifestly meaningless and incomplete fields, appropriate steps should be taken.