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Cover Payments: Background Information and Implications of the new SWIFT Message Format (due to go live on November 21, 2009)

It is important that participants in payment systems are aware of the new SWIFT Message Format, due to go live on November 21, 2009. This statement sets forth relevant background to the initiative that has led to the new message format for cover payments and considers some of the consequences of the use of the new message format for participants in payment systems. These consequences may be substantial.

Background to the Cover Payments Initiative

Due to the design of the payments infrastructure, when cover payments are used, not all payment information available to the originator's bank is currently communicated to the intermediary bank(s) involved in making payments. More specifically, the payment message format used for cover payments, the MT 202 (and the MT 205), which is sent to intermediary banks, does not currently require the inclusion of originator and beneficiary information that is contained in the underlying MT 103 (which is sent to the beneficiary's bank, but not to the intermediary banks when the cover payment is used). As a result, the intermediary banks receiving the MT 202 do not currently receive originator and beneficiary information.

Reflecting a consensus to facilitate greater transparency and to assist financial institutions in their anti-money laundering and sanctions compliance efforts, SWIFT created a variant of the MT 202 (and the MT 205). This variant, the MT 202 COV (and the MT 205 COV), provides for replication of all information contained in certain fields (i.e. fields containing originator and beneficiary information) of the MT 103 and is to be used for cover payments. Please see the presentation referenced at the end of this statement, which provides a basic explanation of various terms used above and further information regarding cover payments and the nature and use of the MT 202 COV.

The proposed message format was subject to approval by SWIFT's membership. The related "country vote" commenced in early December 2007 and concluded with a vote substantially in favor of the proposal. Subsequently issued SWIFT message scope states: "[The new message format, the MT 202 COV] must only be used to order the movement of funds related to an underlying customer credit transfer that was sent with the cover method. The MT 202 COV must not be used for any other interbank transfer. For these transfers the MT 202 must be used," and "[MT 202] must not be used to order the movement of funds related to an underlying customer credit transfer that was sent with the cover method. For these payments the MT 202 COV . . . must be used."

Reaction to the development of the new message format has been positive and welcomed by regulators. In October 2007, the Basel Committee on Banking Supervision issued a statement saying it supported greater transparency in this area, and, after going through a consultative process, the Committee has just issued its paper, "Due diligence and transparency regarding cover payment messages related to cross-border wire transfers," available at www.bis.org. The Committee noted that this paper is consistent with the private sector initiatives supported by the Basel Committee to enhance transparency in payment messages. In this paper, the Committee describes supervisory expectations with regard to originators', cover intermediary, and beneficiary banks, noting that, with reference to cover payment messages, the originator's bank "must ensure that the messages it sends to the cover intermediary bank contain originator and beneficiary information," (paragraph 21) and highlighting the role of supervisors with regard to originators' banks (included in paragraph 38).

It is understood that that responsibility for ensuring the correct use of the MT 202 and MT 202 COV and the inclusion of relevant originator and beneficiary information must rest with the originator's bank and its home country regulatory authorities. The Basel Committee considers this guidance relevant for all supervisors worldwide. This letter reaffirms the industry commitment to ensuring integrity and transparency of the international payment system – but that can only be achieved if each country ensures that originating banks comply with the new message format and adhere to these principles.

Consequences of Use of the New Message Format

Many of the organizations contributing to this statement have vast memberships and specialist groups working on the question of cover payments and seek to apprise others in the industry of the forthcoming changes to the payments system and its implications. In so doing, we have collectively observed that it is appropriate to enhance awareness and understanding of the implications that the introduction of the new SWIFT message format onto the SWIFT network will have for all financial institutions, particularly in terms of the following:

- their usage of message formats and systems modifications
- the ability to ensure straight-through processing of their payments
- how their payments are screened
- an increase in new information that will be available, giving rise to more “hits” and corresponding “false positives” generated by automated monitoring systems
- the appropriate level and training of their staff to handle those hits

Attached is a presentation designed to provide a basic explanation of this initiative, what cover payments are, and possible consequences of use of the new message format. Because these consequences have substantial compliance and operational implications, you should consult about these matters with relevant compliance and operations personnel. To the extent that the organizations making this joint statement can be of assistance to the rest of the industry, or indeed to the financial intelligence community, in providing clarity around the initiative, and its implications, you should feel free to contact the representatives listed below.

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