



# The Introduction of the MT 202 COV in the International Payment Systems



# Issues for Consideration

This presentation considers a new payment message format, the MT 202 COV\*. It is important that participants in the payment systems are aware of the new SWIFT Message Format, due to go live on November 21, 2009. This presentation sets forth relevant background to the initiative leading to the new message format and considers some of the consequences of the use of the new message format for participants in the payment systems, which may be substantial.

For those people who are already familiar with what cover payments are and why they are used, please turn directly to Slide 11.

\* The MT 205 COV will be introduced at the same time and will basically follow the same rules as the MT 202 COV.



## Why this initiative?

- All financial institutions involved in the proposal have risk-based programs that apply systems and controls to both the front and back end of wires processed to comply with local regulations and economic sanctions requirements. This presentation considers how transparency in the global payments system may be further enhanced, focusing on “Cover Payments.”
- The method of using cover payments is fundamental to the effectiveness of the payments system.
- However, due to the design of the payments infrastructure, when cover payments are used, not all payment information available to the originator’s bank is communicated to the intermediary bank that is paying the beneficiary’s bank.
- The messaging practices for cover payments have possible implications for anti-money laundering, anti-terrorist financing efforts, and sanctions compliance.
- To implement a method to make all payment information available to the originator’s bank also available to the other banks in the payment process in a reliable, systematic way is a substantial undertaking.



# The Global Payments System

Over the last 30 years, the world's banks have developed an international payment system that has been instrumental in fostering global economic prosperity, allowing financial transactions to be processed with confidence, speed, and efficiency.

The smooth functioning of this system is vital to global financial stability. The system is large and complex. As Timothy F. Geithner (ex-President and CEO of the Federal Reserve Bank of New York, now US Treasury Secretary) remarked in a speech at the 2004 SWIFT Conference: "The payments infrastructure of the global financial system is a complex patchwork of national and cross-border systems, not seamless, not uniform, but closely connected."

➤ Global Correspondent Banking Network. At the heart of this international payment system is the global correspondent banking network, whereby banks around the world can make payments to and through each other. Within this network, banks communicate and transfer funds to one another.

➤ Domestic and Supranational Systems Most countries have domestic payment systems and there are other supra-national systems (e.g., TARGET).

➤ Role of SWIFT. SWIFT is the infrastructure supporting both global correspondent banking and most domestic payment systems and Real-Time Gross Settlement ("RTGS") networks and involves nearly 8,000 financial institutions (banks, broker-dealers and investment managers) in over 200 countries and territories. In 2007, SWIFT handled more than **3 billion messages** globally (averaging more than **14 million messages per day**).

➤ Role of Central Banks and Regulators. Central Banks and numerous regulators oversee the system.

The global payments system has evolved in a way that, first and foremost, promotes **efficiency and effectiveness**, i.e., the system concentrates on information essential for processing a payment transaction and on including all countries and financial institutions within the system to allow payments to pass readily across international borders.



# Role of the Bank maintaining the Customer Relationship



The role of the bank that maintains the customer relationship is key to an effective AML/ATF/sanctions program –

➤ The financial institution at which an account is opened has the greatest opportunity adequately to assess its potential customer (the Originator, in the case of the Originator's Bank, and the Beneficiary, in the case of the Beneficiary's Bank).

➤ The primary due diligence responsibility must remain with each involved institution to know its own customer and fulfill its own AML, ATF and sanctions obligations, and the banking industry and regulatory community should continue to promote robust safeguards at the point of entry.

➤ It is the Originator's Bank that controls the initiation of the payment messaging process.





# What is a Cover Payment?

- A typical funds transfer involves the Originator instructing its bank (the Originator's Bank) to make payment to the account of a payee (the Beneficiary) with the Beneficiary's Bank.
- In the context of international funds transfers, the Originator's Bank and the Beneficiary's Bank often do not have a relationship that allows them to settle the payment directly.
- Intermediary accounts at Intermediary Banks must be employed to settle the payment. Accordingly, a typical funds transfer may involve multiple banks in multiple jurisdictions.
- The messages (payment orders) used to execute funds transfers are carried over a system such as SWIFT, CHIPS or other RTGS systems.
- SWIFT message protocols allow for the use of the "cover payment" method to pay the Beneficiary's Bank.
- A cover payment involves two distinct message streams (MT 103 & MT 202).
  - MT 103 - Direct payment order to the Beneficiary's Bank, and
  - MT 202 - Bank-to-bank order(s) to Intermediary Bank(s) to cover the Originator's Bank's obligation to pay the Beneficiary's Bank.
- In a cover payment, the Intermediary Bank(s) receiving the MT 202 does not receive the MT 103.
- As a result, the Intermediary Bank(s) have no ability to monitor or filter the payment details involved in the MT 103.
- MT 202's are used for primarily two purposes, namely, cover payments and bank-to-bank payments (i.e., settlement of FX trades, payment of interest, reimbursements under documentary credits, etc.), and the Intermediary Bank(s) cannot distinguish in straight through processing between these two uses.



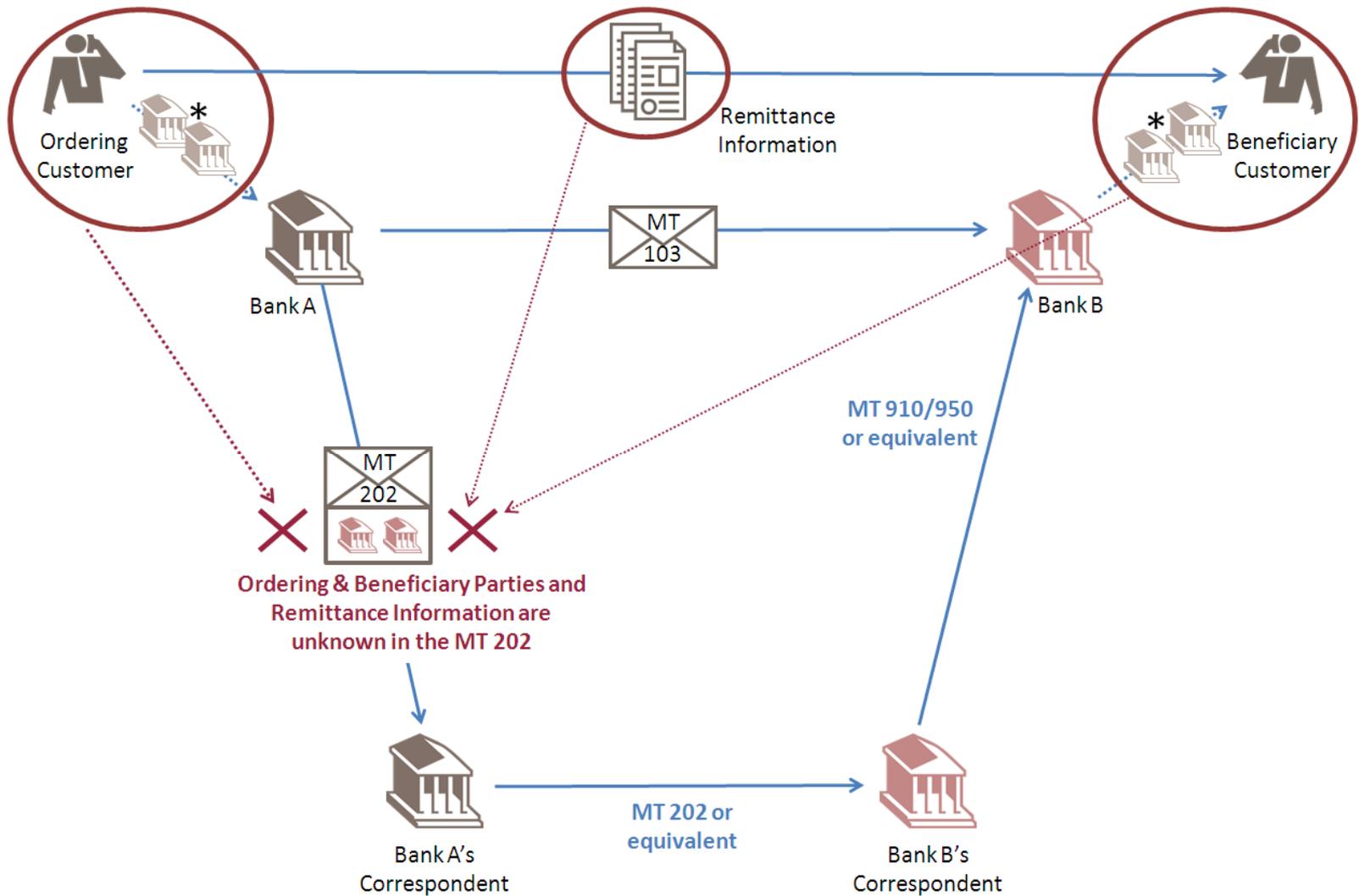
# Consequences of Cover Payments



The current cover payment process does not require the inclusion of Originator and Beneficiary information in the MT 202 from the Originator's Bank and therefore is not presented to other Financial Institutions in the payment process. The MT 202 COV will contain such information, see the next two slides.

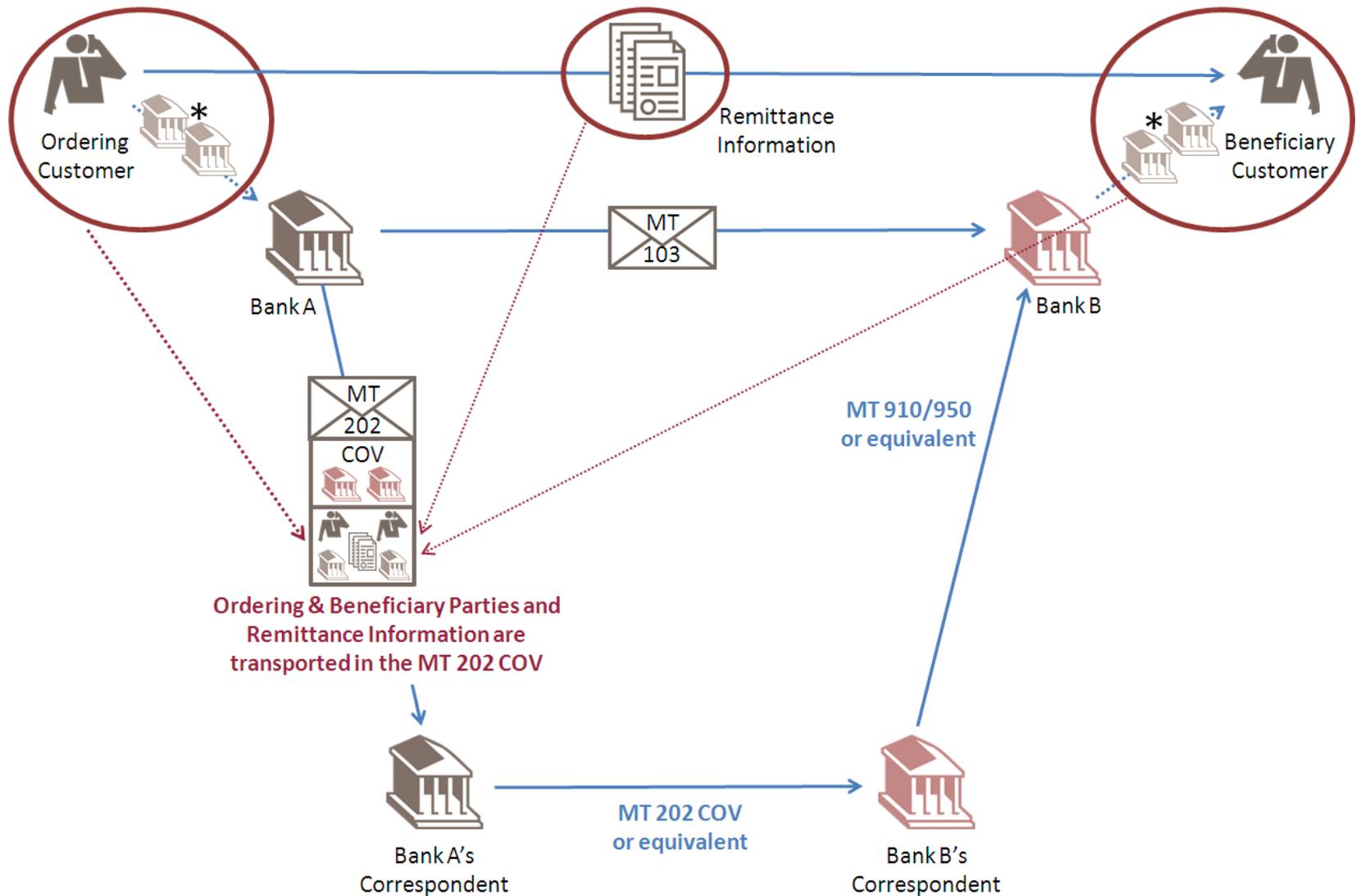


# A Cover Payment



\*The ordering customer may be a customer of Bank A but there may be other banks between Bank A and the ordering customer. Similarly, there may be one or more banks between Bank B and the beneficiary customer.

# A Cover Payment ~ continued



\*The ordering customer may be a customer of Bank A but there may be other banks between Bank A and the ordering customer. Similarly, there may be one or more banks between Bank B and the beneficiary customer.



# Transparency in Payment Messages

## Basel Committee Newsletter No. 12 ~ October 2007



➤ The Basel Committee welcomes the dialogue between the public and private sector over the issue of enhanced transparency for cover payments initiated by the industry through the Wolfsberg Group and the Clearing House Association as well as the proposals under discussion in the SWIFT community to increase the transparency of transfers. A solution improving transparency in international payments should aid anti-crime efforts worldwide.

➤ Cover payments are used in correspondent banking in particular to execute transfers ordered by customers in foreign currencies. This technique of cover payments has advantages for banks, but the current messaging standards do not ensure full transparency for the intermediary banks on the transfers they are helping to execute. This has in some cases raised concerns about the risk that such a type of message could be chosen on purpose to conceal the names of parties to a transaction and about the ability of the intermediary banks to comply with their obligations.

➤ The Committee encourages the industry, which is best placed to design the technical solutions to meet this challenge, to proceed with all the necessary changes in order to implement as soon as feasible these solutions for all relevant standards of messages.

➤ The Committee encourages the effective and genuine use of such solutions.



## The Basel Committee on Banking Supervision Document on Due diligence and transparency regarding cover payment messages related to cross-border wire transfers

- In July 2008, the Basel Committee published its preliminary views on supervisory expectations relating to transparency in payment messages, particularly in anticipation of changes to technical standards for cross-border wire transfers.
- In May 2009, after a consultative process, the Committee issued its final document.
- In the final paper, the Committee describes supervisory expectations with regard to originators' banks, cover intermediary banks and beneficiary banks, noting that, with reference to cover payment messages, the originators' 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).



# Issues to consider in preparing for the SWIFT Release of Nov. 21<sup>st</sup> 2009



## From an operational perspective



➤ Need for banks (and vendors) to address use of message formats and make systems changes



➤ The ability to ensure straight-through processing



➤ Increase in hits and consequently in "false positives" and blocked/rejected payments due the increase in quantity of information contained in the payment message

➤ Need to have appropriate level and training of relevant personnel ready for November 21<sup>st</sup>, 2009

➤ Consideration of a process to handle the MT 103 if a corresponding MT 202 COV gives rise to a true hit, and the cover is not forthcoming





# Issues to consider in preparing for the SWIFT Release of Nov. 21<sup>st</sup> 2009 (continued)

## From a general awareness perspective

➤ There needs to be more awareness of the appropriate use of the new message format, the MT 202 COV, which will go "live" in only a matter of months.

➤ In this regard, it should be noted that SWIFT characterizes the relevant message scope of the MT 202 COV and the MT 202, as they are contemplated to be used starting November 21, 2009, as follows:

➤ “[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 “[The 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.”

➤ The characterization of the relevant message scope does not distinguish on the basis of the currency or jurisdiction involved, but, rather, is general in its application.

➤ The SWIFT User Handbook provides that if a message type exists for a particular class of transactions, then customers must use that message type.

➤ The availability of the MT 202COV will not preclude the use of the MT 103 on a serial basis.

➤ Financial Institutions need to ensure that they have adequate resources allocated to hit-handling

➤ Law enforcement needs to ensure that their community is aware that this message change will be implemented before year-end, and of the implications it may have for them



## Additional Resources



- Basel Committee on Banking Supervision Due Diligence and Transparency regarding cover payment messages related to cross border wire transfers

- <http://www.bis.org/publ/bcbs154.pdf>



- SWIFT Handbook

- [http://www.swift.com/about\\_swift/press\\_room/swift\\_news\\_archive/home\\_page\\_stories\\_archive\\_2009/SWIFTlimitsStandardsMTRelease2009tominimisecustomerimpactinfinancialcrisis.page](http://www.swift.com/about_swift/press_room/swift_news_archive/home_page_stories_archive_2009/SWIFTlimitsStandardsMTRelease2009tominimisecustomerimpactinfinancialcrisis.page)



- SWIFT MT 202 COV Training

- [http://www.swift.com/training/training\\_topics/payments\\_and\\_cash\\_management/MT202COV-standards\\_release\\_seminar.page](http://www.swift.com/training/training_topics/payments_and_cash_management/MT202COV-standards_release_seminar.page)



- Payment Market Practice Group Guidelines for the use of the MT 202 COV

- [www.pmpg.info](http://www.pmpg.info)



- Wolfsberg/Clearing House Message Payment Standards

- [http://www.wolfsberg-principles.com/pdf/WG-NYCH\\_Statement\\_on\\_Payment\\_Message\\_Standards\\_April-19-2007.pdf](http://www.wolfsberg-principles.com/pdf/WG-NYCH_Statement_on_Payment_Message_Standards_April-19-2007.pdf)



# Contact Details



Donna K. Alexander  
Managing Director  
**Banker's Association for Finance & Trade**  
dalexander@aba.com



Joe Alexander  
Senior Counsel  
**The Clearing House Association L.L.C.**  
Joe.Alexander@theclearinghouse.org



Sébastien de Brouwer  
Head of Department, Retail Financial Services, Legal & Social Affairs  
**European Banking Federation**  
S.deBrouwer@ebf-fbe.eu



Sally Scutt  
Managing Director  
**International Banking Federation**  
sally.scutt@bba.org.uk



Thierry Sénéchal  
Policy Manager, Banking & Financial Services Commissions  
Secretary, Corporate Economists Advisory Group (CEAG)  
**International Chamber of Commerce (ICC)**  
thierry.senechal@iccwbo.org



Marilyn Skiles  
Secretary General  
**International Council of Securities Associations**  
mskiles@sifma.org

Dan Taylor  
President and Chief Executive Officer  
**International Financial Services Association**  
dan.taylor@intlbanking.org

Gottfried Leibbrandt  
Head of Markets  
**SWIFT**  
gottfried.leibbrandt@swift.com

Tracy Paradise  
Executive Secretary  
**The Wolfsberg Group**  
tracy.paradise@ubs.com