



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 09-09

December 18, 2009

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Interagency Guidance on Transparency and Compliance in Cross-Border Funds Transfers

The Federal Reserve, together with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration, has issued the attached interagency guidance on “Transparency and Compliance for U.S. Banking Organizations Conducting Cross-Border Funds Transfers.” The interagency guidance references the attached paper, issued by the Basel Committee on Banking Supervision in May 2009, entitled *Due diligence and transparency regarding cover payment messages related to cross-border wire transfers* (available at www.bis.org).

The interagency guidance clarifies the U.S. federal banking supervisors’ perspective on certain points in the Basel Committee paper, including expectations for intermediary banks on Office of Foreign Assets Control sanctions screening and transaction monitoring to comply with Bank Secrecy Act/anti-money laundering requirements. In addition, it discusses the banking supervisors’ approach to reviewing institutions’ risk management practices with respect to cross-border funds transfers, including cover payments.

Reserve Banks are asked to distribute this SR letter to all state member banks, bank holding companies, and foreign banking organizations as well as to their own supervisory and examination staff. Questions regarding this letter may be directed to Nina Nichols, Assistant Director, at (202) 452-2961; or Suzanne Williams, Manager, BSA/AML Risk, at (202) 452-3513.

Patrick M. Parkinson
Director

Attachments:

- [Interagency guidance on “Transparency and Compliance for U.S. Banking Organizations Conducting Cross-Border Funds Transfers”](#)
- [*Due diligence and transparency regarding cover payment messages related to cross-border wire transfers*](#), Basel Committee on Banking Supervision

**Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Office of Thrift Supervision
National Credit Union Administration**

**Transparency and Compliance for U.S. Banking Organizations
Conducting Cross-Border Funds Transfers**

In May 2009, the Basel Committee on Banking Supervision issued a paper addressing transparency in cross-border cover payment messages (BIS Cover Payments Paper).¹ The paper discusses the risks inherent in cover payment arrangements where an originator's bank does not send full transaction information to an intermediary bank (cover intermediary), and the cover intermediary is consequently unable to effectively filter or monitor transactions. The lack of transparency can impair the cover intermediary's risk management and compliance, particularly for cross-border transactions.

The paper notes that cover payments effected through SWIFT messages should be more transparent as of November 21, 2009, when the new MT 202 COV payment format takes effect. The MT 202 COV will be mandatory for any bank-to-bank transfer that is a cover payment on behalf of a customer of the originator's bank, and the MT 202 COV contains mandatory fields for information relating to the originator and beneficiary of the transfer. The MT 202 COV will increase the transparency of transactions by providing a cover intermediary with additional information about the originator and beneficiary, similar to what can be effected by the use of serial SWIFT MT 103 payment orders.²

The BIS Cover Payments Paper encourages increased transparency for cross-border cover payments, and it encourages all banks involved in international payments transactions to adhere to the message standards developed by the New York Clearing House and the Wolfsberg Group in 2007 (Message Standards). These are:

- Financial institutions should not omit, delete or alter information in payment messages or orders for the purpose of avoiding detection of that information by any other financial institution in the payment process;
- Financial institutions should not use any particular payment message for the purpose of avoiding detection of information by any other financial institution in the payment process;
- Subject to all applicable laws, financial institutions should cooperate as fully as practicable with other financial institutions in the payment process when requested to provide information about the parties involved; and

¹ Basel Committee on Banking Supervision, *Due diligence and transparency regarding cover payment messages related to cross-border wire transfers*, May 2009, www.bis.org.

² A COV variation will also be available for the MT 205 message, which can be used for messages that are not sent internationally.

- Financial institutions should strongly encourage their correspondent banks to observe these principles.

The paper also discusses supervisory expectations relating to increased transparency. The paper does not create new obligations for any institutions beyond what is required by applicable law and regulation of their jurisdictions. In consultation with the Office of Foreign Assets Control (OFAC) and Financial Crimes Enforcement Network, the U.S. federal banking supervisors are issuing this interagency guidance to clarify the supervisory perspective on certain key points addressed by the BIS Cover Payments Paper.³

1. Use of MT 202 COV by U.S. Originators' Banks.

The existing MT 202 message format will remain effective for bank-to-bank transactions but should not be used for cover payments, according to SWIFT standards. For all MT 202 payments for which there is an associated MT 103, the MT 202 COV will be mandatory and must be used. The MT 202 COV will contain mandatory fields for originator and beneficiary information, which will enable the originator's bank to forward to the cover intermediary information about the transaction to assist the cover intermediary in performing sanctions screening and suspicious activity monitoring.

The federal banking agencies expect the MT 202 COV to be used by U.S. originators' banks for all cover payment transactions for which there is an associated MT 103, whether or not they are cross-border transfers. The agencies believe that risks associated with cover payments effected through SWIFT can be mitigated by use of the MT 202 COV, and that the MT 202 COV format should be used by U.S. banks and their correspondent banks. Where the travel rule (31 CFR 103.33(g)) applies to a funds transfer by a U.S. originator's bank, compliance can be achieved by including the required information on the MT 202 COV. The agencies note that use of the MT 202 when the MT 202 COV is available and appropriate is inconsistent with the Message Standards. A U.S. bank's procedures should address the appropriate use of the new message format for transactions in which the bank acts as the originator's bank.

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

a. Sanctions screening. Consistent with current practices, U.S. banks should screen transactor information on all automated funds transfers and should block or reject transactions as required by law and make required reports to OFAC. All MT 202 and MT 202 COV messages should be subject to screening. The introduction of the MT 202 COV format does not change U.S. sanctions obligations, but may increase the amount of information available to be screened.

³ References in this document to banks and depository institutions should be understood to include all financial institutions supervised by the issuing agencies, including banks, thrifts, credit unions and non-bank subsidiaries.

b. Blank fields in the MT 202 COV. Where an MT 202 COV contains a blank field (*i.e.*, an empty field, with no characters present) for originator or beneficiary, SWIFT will reject the message and the cover intermediary will not receive any payment instruction.

c. Risk-based monitoring of MT 202 COV payments. U.S. cover intermediary banks should conduct monitoring of funds transfers that are processed through their automated systems to identify suspicious activity. This monitoring may be conducted after the transfers are processed, on an automated basis, and may utilize a risk-based approach. The MT 202 COV will provide cover intermediary banks with additional information for risk management, which can be achieved through subsequent review of transaction information using risk factors identified by the cover intermediary bank. The monitoring process may be similar to that for MT 103 payments.

Neither the SWIFT format change nor the BIS Cover Payments Paper suggests that intermediary banks must gather information relating to incomplete fields in all payment orders or must verify the accuracy of information contained in payment message fields. The paper notes that the cover intermediary should have a process for addressing situations where a risk-based approach to monitoring flags a field that is “manifestly meaningless or incomplete,” *i.e.*, where it is obvious, without further research or investigation, that the message does not identify parties to a transaction. The agencies recognize that, given the volume of messages and data for large U.S. cover intermediary banks, a manual review of every payment order may not be possible. However, banks should have, as part of their monitoring processes, a risk-based method to identify incomplete fields or fields with meaningless data. U.S. banks engaged in processing cover payments should have policies to address such circumstances in connection with risk management for correspondent banking services, and should within reasonable timeframes develop and implement plans for adapting automated monitoring systems.

d. Monitoring of MT 202 payments. Requirements for U.S. cover intermediary banks relating to MT 202 messages have not changed. Intermediary banks should monitor transactions using a risk-based approach. U.S. banks are subject to the correspondent bank due diligence requirements of section 312 of the USA PATRIOT Act and corresponding regulations.

Availability of the MT 202 COV format should not impact intermediary banks’ compliance policies and procedures with regard to MT 202 messages. In managing risks associated with a correspondent account, however, a cover intermediary should factor into its risk assessment a correspondent bank’s policy and practice of sending messages without utilizing the MT 202 COV where available, and should have appropriate controls in place for such circumstances. U.S. banks should strongly encourage their correspondent banks to observe the Message Standards.

3. Supervisory Approach.

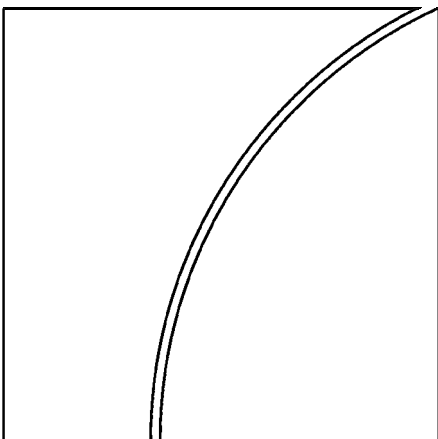
Examiners should continue to review institutions' correspondent banking practices to ensure that those practices are consistent with current regulatory requirements and supervisory expectations.⁴ Examiners may take several steps to assess an institution's risk management practices with respect to cross-border cover payments, including the following:

- 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).
- 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.
- 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.

Supervisors should be satisfied that a bank has appropriate internal controls in place to monitor wire transfer activity, that these controls are effective, and that the bank complies with applicable regulatory guidance.

⁴ See FFIEC BSA/AML Examination Manual, sections on "Foreign Correspondent Account Recordkeeping and Due Diligence," and "Correspondent Accounts (Foreign)," (2007).

Basel Committee on Banking Supervision



Due diligence and transparency regarding cover payment messages related to cross- border wire transfers

May 2009



BANK FOR INTERNATIONAL SETTLEMENTS

Requests for copies of publications, or for additions/changes to the mailing list, should be sent to:

Bank for International Settlements
Press & Communications
CH-4002 Basel, Switzerland

E-mail: publications@bis.org
Fax: +41 61 280 9100 and +41 61 280 8100

© *Bank for International Settlements 2009. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

ISBN print: 92-9131-772-1
ISBN web: 92-9197-772-1

Table of Contents

I.	Information flows	5
II.	The roles of banks processing cross-border wire transfers.....	5
	A. The responsibility of originators' banks	6
	B. The responsibility of cover intermediary banks	7
	1. Monitoring to ensure fields are not left blank	7
	2. Monitoring against lists of names.....	8
	3. Monitoring of the correspondent relationship.....	9
	C. The responsibility of beneficiaries' banks.....	10
	D. Customer information and data protection issues	10
	E. Other issues	11
III.	The role of supervisors.....	11

Due diligence and transparency regarding cover payment messages related to cross-border wire transfers

1. The processing of cross-border wire transfers¹ frequently involves several financial institutions. In addition to the originator's bank and the beneficiary's bank, additional banks are often involved. This paper examines the circumstances where one or more of these cover intermediary banks² is located in a jurisdiction other than the jurisdictions where the bank of the originator and the bank of the beneficiary are located. It describes the supervisory expectations, pursuant to the current initiatives supported by the Basel Committee to enhance transparency in payment messages, about information that must be included in payment messages related to cover payments, the various mechanisms that must be used to ensure that complete and accurate information has been included in such messages, the different roles of parties involved in these mechanisms and the use that should be made of the information for AML/CFT purposes.

2. Cover payments are used by a bank to facilitate funds transfers on behalf of a customer to a beneficiary, most often in another country, but also in the same country when a foreign currency is used. They typically involve both (i) a transaction in a currency other than that of the country in which the originator's or beneficiary's bank is domiciled, and (ii) the originator's and beneficiary's banks not having a relationship with each other that allows them to settle with each other directly. In this circumstance, the originator's bank may directly instruct the beneficiary's bank to effect the payment and advise that transmission of funds to "cover" the interbank obligation created by the payment order has been arranged through a separate channel. Settlement is often accomplished through the originator bank's correspondent in the country where the national currency is the currency of the payment. If the originator bank's correspondent has a relationship with the beneficiary's bank, it can settle the payment itself; otherwise, settlement generally takes place through an additional intermediary bank that has a relationship with the beneficiary's bank. In current practice, the beneficiary can have his account credited by its own bank before interbank settlement is completed, especially when there is a robust commercial relationship.

3. This cover payment mechanism, where the cover intermediary banks do not necessarily see all the information sent to the beneficiary bank, is distinct from the direct sequential chain of payment envisaged in the FATF Special Recommendation VII on wire transfers, where the information sent to the beneficiary banks goes through the various intermediaries (see graph hereunder). Its most frequent use is to avoid the delays associated with differences in time zones between the originator's bank and the beneficiary's bank and to reduce costs of commercial transactions.

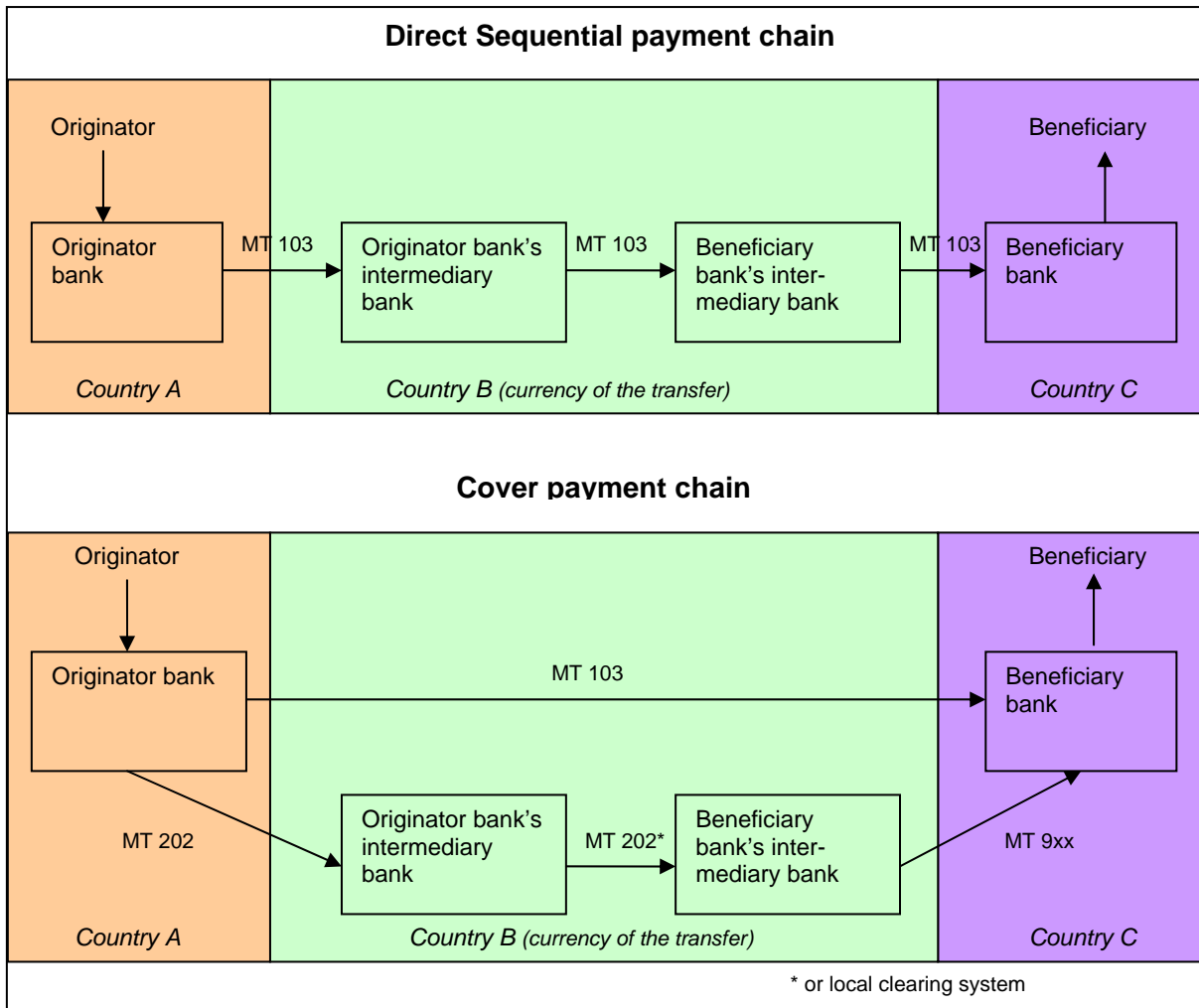
¹ The FATF Interpretative Note to SR VII defines a wire transfer as "any transaction carried out on behalf of an originator person (both natural and legal) through a financial institution by electronic means with a view to making an amount of money available to a beneficiary person at another financial institution. The originator and the beneficiary may be the same person." Under the FATF definition, a cross-border transfer means any wire transfer where the originator and beneficiary institutions are located in different countries. This term also refers to any chain of wire transfers that has at least one cross-border element. A wire transfer where the originator and beneficiary are in the same jurisdiction, but where one or more correspondents in a third country are used, would consequently be considered a cross-border wire transfer

² The term "cover intermediary bank" is used in this paper to highlight the difference between the role of an intermediary bank in sequential payments, which are not dealt with in this paper, and the role of an intermediary in the cover payment chain.

4. Existing messaging practices do not ensure full transparency for the cover intermediary banks on the transfers they facilitate. Transparency is limited when the message format used to settle the interbank payment (in the example, below, a SWIFT MT 202) does not contain information about the originators and beneficiaries. Such information is however included in the message sent to the beneficiary bank (in the example, below, a SWIFT MT103). Lack of originator and beneficiary information for funds transfers can hinder or limit a cover intermediary bank's ability to accurately assess risks associated with correspondent and clearing operations. The cover intermediary bank would also be unable to screen transactor information against locally applicable lists of individuals or entities whose assets, under local law, must be blocked, rejected or frozen. This could be particularly problematic where the list of the intermediary bank's country is more comprehensive than the list of the originator's (or beneficiary's) country. There is also a risk that such messages could be chosen on purpose to conceal the names of parties to a transaction. To comply with locally applicable requirements, such as the blocking, rejecting or freezing of assets of designated individuals or entities, cover intermediary banks thus might need to receive originator and beneficiary information.

5. More detailed information regarding originators and beneficiaries of funds transfers can improve compliance with locally applicable requirements (such as the blocking, rejecting or freezing of assets of designated individuals or entities and monitoring for suspicious activity) and enhance a bank's risk management processes with respect to funds transfers. An industry effort initiated by the Wolfsberg Group and the Clearing House Association seeks to enhance transparency through (i) the adoption of certain basic payment message standards within the banking industry (the "Message Standards"); and (ii) the creation of an enhanced SWIFT payment message format for third-party cover payments that will accommodate information about the originator and the beneficiary of the payment.³ Following this initiative, the SWIFT Community is developing a technical solution which will allow complete originator and beneficiary information to be transmitted with cover payments in a standardized manner. The implementation of this solution is planned for November 2009. Other messaging standards could also be developed to include enhanced transparency.

³ The Wolfsberg Group, Clearing House Statement on Payment Message Standards: www.wolfsberg-principles.com/pdf/WG-NYCH_Statement_on_Payment_Message_Standards_April-19-2007.pdf



6. In its October 2007 newsletter,⁴ the Basel Committee encouraged this evolution for all relevant standards of messages. The Committee also announced at that time its intention to explore the development of supervisory policies to support the implementation of transparency efforts in the industry.

7. The Committee has called for the effective and genuine use of the technical solutions designed to enhance transparency. Indeed, increasing transparency in payment messages does not depend on messaging standards alone, but also on the implementation of appropriate practice by banks involved in processing the transfers, having regard to the good functioning of payment systems. The industry has already been working on the definition of good practices.⁵ Supervisors have their role to play in monitoring an effective and consistent implementation of increased transparency in payment messages worldwide. This document, following previous work by the Basel Committee on a common supervisory approach to Customer Due Diligence (CDD) and AML/CFT issues, thus describes common supervisory expectations as to the information that should accompany cover payment messages and the respective roles of the originator's bank, the cover intermediary banks and

⁴ Basel Committee newsletter No 12 *Transparency in payments messages* (www.bis.org/publ/bcbs_n12.htm)

⁵ For instance, the Wolfsberg Group, Clearing House Statement on Payment Message Standards (see footnote 3 above) and the Payments Market Practice Group's *Market Practice Guidelines for use of the MT 202 COV1 (Version 1.0, September, 2008, <http://pmpg.webexone.com/login.asp?loc=&link=>)*.

the beneficiary's bank concerning this information. The guidance also describes a common understanding of the supervisory tasks regarding transparency in cover payments messages related to cross-border transfers.

Timing of implementation

8. The implementation of suitable technical solutions, such as the one mentioned above, is prerequisite for the implementation of enhanced transparency and related supervisory expectations described in this document. Banks are expected to include the information in Section I and perform their role as in Section II as soon as technically feasible.

Scope of implementation

9. The Basel Committee considers this guidance relevant for all supervisors worldwide. The guidance corresponds to the implementation of existing standards, laws and regulations to the specific case of cover payments. While it does not create any new obligations, as the bank's obligations are determined by their own national law implementing international and national standards, it does express the common understanding of the Committee about how increased transparency should be encouraged for international cover payments and the common supervisory expectations related to this increased transparency at the international level.

10. This guidance is intended to address the issues relevant for international cooperation, and thus to apply to cover intermediary banks located in a jurisdiction other than the jurisdictions where the bank of the originator and the bank of the beneficiary are located. As a consequence, this guidance is not meant to apply to other intermediary banks in payments. For instance, the guidance would not apply to cover intermediary banks that are located in the same jurisdiction as either the originator bank or beneficiary bank⁶. Also, the guidance would only apply to the first, and not subsequent, cover intermediary banks located in the same jurisdiction. Cover intermediary banks not included in the scope of this guidance will be governed solely by their national law applying international and national standards.

11. The European Union (EU) and the European Economic Area (EEA) are considered here as one jurisdiction, in accordance with the FATF decision of February 2008.⁷ Consequently, this guidance does not apply to any chain of wire transfers that takes place entirely within the borders of the EU/EEA.

12. If a *de minimis* threshold exists in the originator's jurisdiction but not in the one of the cover intermediary bank, it appears that a solution similar to the one in the interpretative note to FATF Special Recommendation VII⁸ should apply and that countries may nevertheless require that incoming cross-border cover payment messages contain full and accurate originator and beneficiary information.

⁶ The reference to a single jurisdiction also includes cases where two countries or more are considered to be a single jurisdiction

⁷ See note to assessors under criteria VII.3, FATF methodology, p. 69, <http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf>

⁸ [http://www.fatf-gafi.org/document/53/0,3343,en_32250379_32236947_34261877_1_1_1_1,00.htm#INSRVII, paragraph 4b](http://www.fatf-gafi.org/document/53/0,3343,en_32250379_32236947_34261877_1_1_1_1,00.htm#INSRVII,paragraph 4b)

I. Information flows

13. The information about the originator that must accompany international wire transfers has been defined in general terms by the FATF. The issue of cover payments is not directly dealt with in the FATF standards, and this paper, among other things, clarifies supervisory expectations about which information must be made available to cover intermediary banks that process cover payments after the adoption of the new messaging standards allowing enhanced transparency. Insofar this document is meant to be consistent with the FATF recommendation on wire transfers and its interpretative note.

14. The FATF states in Special Recommendation (SR) VII that “Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number⁹) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain.” The FATF Interpretative Note also specifies that financial institutions processing an intermediary element of chains of wire transfers must ensure that all originator information that accompanies a wire transfer is retained with the transfer. This standard is intended “to ensure that basic information on the originator of wire transfers is immediately available [to public authorities and] to beneficiary financial institutions to facilitate the identification and reporting of suspicious transactions”.

15. The Basel Committee considers that information on originators and beneficiaries should be included in all messages sent to cover intermediary banks processing cross-border wire transfers related to specific customer transactions to ensure enhanced transparency for all banks participating in the operation and full compliance with all applicable standards. As noted in the introduction, this requires the prior implementation of suitable technical standards for cover payment messages.

II. The roles of banks processing cross-border wire transfers

16. The purpose of this section is to set out supervisory expectations concerning the respective roles of the originator’s bank, the cover intermediary banks and the beneficiary’s bank in processing a cross-border cover payment for a wire transfer. Originating banks should ensure that appropriate information accompanies wire transfers while others in the payment chain are required to monitor the payment they process based on this information.

17. The Basel Committee encourages all banks to apply high transparency standards, in full compliance with applicable national laws and regulations, in the context of cover payments initiated to settle a customer transaction. In particular:

⁹ The FATF interpretative note specifies that “Information accompanying qualifying cross-border wire transfers must always contain the name of the originator and where an account exists, the number of that account. In the absence of an account, a unique reference number must be included. Information accompanying qualifying wire transfers should also contain the address of the originator. However, countries may permit financial institutions to substitute the address with a national identity number, customer identification number, or date and place of birth.” Countries “may adopt a de minimus threshold (no higher than USD or EUR 1,000). For cross-border transfers below this threshold: (i) Countries are not obligated to require ordering financial institutions to identify, verify record, or transmit originator information. (ii) Countries may nevertheless require that incoming cross-border wire transfers contain full and accurate originator information.”

- Appropriate information should be included in payment messages as described in this document. Financial institutions should not omit, delete or alter information in payment messages, for the purpose of avoiding detection of that information by any other financial institution in the payment process.
- Financial institutions should not use any particular payment message for the purpose of avoiding detection of information by any other financial institution in the payment process.
- Subject to all applicable laws, financial institutions should cooperate as fully as practicable with other financial institutions in the payment process when requested to provide information about the parties involved.
- Financial institutions should take into account in their correspondent bank relationship the transparency practices of their correspondents.

18. Concerning information flows, it is the responsibility of the originator's bank to ensure that complete information is included for each wire transfer. However, the beneficiary and cover intermediary banks also have their roles to play in ensuring appropriate flows of information.

19. Monitoring of customers is an essential aspect of effective AML/CFT procedures.¹⁰ However, effective monitoring for AML/CFT purposes requires an understanding by banks of normal and reasonable account activity of their customers so that they have a means of identifying transactions which fall outside the regular pattern of an account's activity. This has an impact on monitoring responsibilities which are not the same for the banks that have direct information on their non bank customers and for the cover intermediary banks that only manage a commercial relationship with other banks for the purpose of effecting payments and thus are not expected to be able to conduct such monitoring on the final customers (see *infra* §21).

A. The responsibility of originators' banks

20. As expressed in the FATF interpretative note, the ordering (originating) financial institution must ensure that cross-border wire transfer messages contain complete originator information.¹¹ The ordering financial institution is responsible for the customer due diligence on the originator. It must verify originator information for accuracy and maintain this information in accordance with local regulatory requirements implementing FATF standards.

21. The originator's bank must ensure that the messages it sends to the cover intermediary bank contain originator and beneficiary information. The originator information should be in compliance with local regulatory requirements implementing FATF SR VII and its interpretative note. The information on the beneficiary should at least include its name or an identifier code (such as a Business Entity Identifier¹²) as well as the other beneficiary information sent directly to the bank of the beneficiary, if any. Banks should be encouraged, where possible, to include other identity information on the beneficiary, where this is necessary to limit the risk of customer assets being incorrectly frozen, blocked or rejected or

¹⁰ Basel Committee on Banking Supervision, *Customer due diligence for banks*, October 2001, paragraph 53.

¹¹ See footnote 8.

¹² An identifier code (such as a Business Entity Identifier) could be used instead of a name, provided it allows the intermediary bank to easily and reliably find the beneficiary's name and allows automated screening against lists of names.

of the cover payment being unduly delayed. The beneficiary information will have been obtained from the originator. The originator's bank policies should address:

- record keeping,
- the verification of originator information,
- the message formats and the circumstances in which the formats should be used,
- the information to include in messages.

22. Under SWIFT standards, the inclusion in the cover payment message (MT202COV) of the originator and beneficiary information contained in the MT 103 will be mandatory. Messages with a mandatory field left blank would be rejected by SWIFT.

23. Consistent with FATF standards and the Basel Committee document *Customer due diligence for banks*, originator banks should include international wire transfers in their ongoing due diligence on the business relationship with the originator and in their scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, its business and risk profile, including, where necessary, the source of funds.¹³ Many jurisdictions will authorise banks to use a risk-based approach which should be regularly audited in order to assess its effectiveness.

B. The responsibility of cover intermediary banks

24. As mentioned above, under FATF Special Recommendation VII, the primary responsibility of intermediary banks in sequential payments is to "ensure that all originator information that accompanies a wire transfer is retained with the transfer". In addition, FATF Recommendation 7 on Correspondent banking, as well as paragraphs 49 to 52 of the Basel Committee's document *Customer due diligence for banks*, have defined the due diligence that intermediaries should perform concerning banks that are offered correspondent banking services. This paper is not intended to alter those principles, but rather to highlight the specific issues related to cross border cover payments through correspondent banks.

1. Monitoring to ensure fields are not left blank

25. As mentioned above, cover payment messages with originator and beneficiary fields left blank would be rejected by SWIFT. In the case where they would be using other systems or processes that do not ensure that originator and beneficiary fields are not left blank, banks acting as intermediaries should:

- have reasonable policies in place to ensure, in real time, that required originator and beneficiary fields of cross border cover payment messages are not blank.
- Where fields are blank, take appropriate measures, in compliance with applicable national law. This could entail, for example, (i) declining to process the transaction; (ii) obtaining the missing information from the originator's bank or the precedent

¹³ "The degree and nature of monitoring by a financial institution will depend on the size of the financial institution, the AML/CFT risks that the institution has, the monitoring method being utilised (manual, automated or some combination), and the type of activity under scrutiny" FATF, *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing*, June 2007, paragraph 3.12.

intermediary bank;¹⁴ and/or (iii) filing a report of suspicious activity with local authorities.

- document decisions taken and the reasons for them.

2. Monitoring against lists of names

26. Unlike intermediaries in sequential payment chains that already have this information, access to originator and beneficiary information will be a new development for cover intermediary banks. Once the technical change will have been implemented, the cover intermediary bank in a cross-border cover payment would, in order to secure compliance with its national law, screen the originator and beneficiary names against the lists of individuals and entities whose assets must be blocked, rejected or frozen, as applicable in its jurisdiction. The requirement to block, reject or freeze cannot be risk-based.¹⁵

27. Some cover intermediary banks could be in a situation where screening the originator and beneficiary names against the lists of individuals and entities whose assets must be blocked, rejected or frozen, would duplicate screening conducted by the originator bank. This might, for example, be the case where:

- the list applicable to banks is the same in the different jurisdictions involved in the wire transfer.
- the originator and cover intermediary banks belong to the same corporate group, and all group entities use for their screening a unified list defined by head office, in accordance with the Basel Committee's *Consolidated KYC risk management*,¹⁶ and this list includes names applicable to all the banking group's locations.¹⁷
- the originator bank voluntarily screens, in the case of outgoing cross-border transfers, originators and beneficiaries names against lists applicable in the jurisdiction of the cover intermediary bank,¹⁸ and only proceeds with transfers if no counterparty is listed in the latter jurisdiction. The objective of the originator bank could be for instance to avoid the legal difficulties that could arise where individuals or entities that were not targeted in the originator's or beneficiary's jurisdiction were listed in the intermediary's jurisdiction, and the funds were frozen in the latter.¹⁷

28. A cover intermediary bank confronted with this or a similar situation may wish to consider relying on its respondent to conduct the required screening. In jurisdictions that allow this kind of reliance, a cover intermediary bank inclined to pursue this option should do so with the understanding that it remains responsible for compliance with domestic law even

¹⁴ In cases (i) and (ii), the cover intermediary bank should take reasonable steps to inform the originator's and beneficiary's banks as soon as possible that the cover payment is rejected or delayed.

¹⁵ FATF, *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing*, June 2007, paragraph 1.40: "Requirements to freeze assets of identified individuals or entities, in jurisdictions where such requirements exist, are independent of any risk assessment. The requirement to freeze is absolute and cannot be impacted by a risk-based process."

¹⁶ Basel Committee on Banking Supervision, *Consolidated KYC Risk Management*, October 2004, paragraph 19.

¹⁷ In this case, the originator's bank should consider, identify, assess and mitigate its legal and compliance risk according to applicable obligations in its national legislation

¹⁸ The originator bank might also, for the same reasons, take into account the list applicable in the jurisdiction of the beneficiary. We however focus here on the consequences for the cover intermediary bank of the originator bank's screening.

though it has outsourced a screening function. The intermediary's enhanced due diligence described in FATF Recommendation 7 and paragraph 50 of the paper *Customer due diligence for banks* provide useful guidance on steps the cover intermediary bank should consider in determining whether it is appropriate to rely on a respondent for screening. In particular, the respective responsibilities of each institution should be clearly described, and the cover intermediary bank should assess the respondent institution's screening procedures and related controls before entering a correspondent relationship with the respondent and on a periodic basis during such relationship. This could be done for example by conducting, ex post and depending on a risk-based assessment, its own screening on the originator and beneficiary names for a sample of transfers.

3. Monitoring of the correspondent relationship

29. Cover intermediary banks should monitor their relationships with correspondent banks, in accordance with the principles on correspondent banking.¹⁹ Such monitoring will allow the cover intermediary bank to assess whether the respondent bank's activity and AML/CFT controls are consistent with those ascertained at the outset of the relationship and as subsequently updated.²⁰ Here also, many jurisdictions will authorise banks to use a risk-based approach. Under such an approach, and depending on national requirements as well as the institution's risk assessment, the monitoring would likely be conducted subsequent to the transaction, and its frequency and depth would be determined by the results of the risk assessment made by the cover intermediary bank concerning its correspondent banks.

(a) Monitoring for manifestly meaningless or incomplete fields

30. As a part of the monitoring of correspondent banking relationships and according to their national laws, cover intermediary banks should develop and implement reasonable policies and procedures for monitoring payment message data subsequent to processing and address manifestly meaningless or incomplete fields in payment messages. It is understood that many jurisdictions will allow banks to apply a risk-based approach, and risk factors have been identified by the FATF and the Wolfsberg Group.²¹ Where fields are manifestly meaningless or incomplete, responses could include, for example, (i) contacting the originator's bank or precedent cover intermediary bank in order to clarify or complete the information received in the required fields; (ii) considering (in the case of repeated incidents involving the same correspondent or in the case where a correspondent declines to provide additional information) whether or not the relationship with the correspondent or the precedent cover intermediary bank should be restricted or terminated; banks should report such situations to their supervisor; and/or (iii) filing a report of suspicious activity with the local authorities, when the situation satisfies the local definition of reporting requirements. The reasons for decisions taken should be documented.

¹⁹ Basel Committee on Banking Supervision, *Customer due diligence for banks*, October 2001, paragraphs 49 to 52.

²⁰ FATF Recommendation 5 requires that due diligence be conducted on existing relationships at appropriate times. The Interpretative Note refers to the Basel Committee's *Customer due diligence for banks*, October 2001 (see paragraph 24).

²¹ See FATF, *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing*, June 2007, in particular paragraph 1.43 and 3.20, and The Wolfsberg Group, *The Wolfsberg Anti-Money Laundering Principles for Correspondent Banking*, 21 October 2002, www.wolfsberg-principles.com. Banks should focus on the factors that are relevant when assessing the risk of manifestly meaningless or incomplete transfers being sent.

(b) Monitoring for suspicious activities

31. As neither the originator nor the beneficiary are the cover intermediary bank's customers, the cover intermediary bank is usually not in a position to understand the purpose of such transactions, nor conduct CDD on these persons. Consequently, the cover intermediary bank is unlikely to be in a position to determine whether the transaction represented by the cover payment is suspicious, based on an understanding of the activities of the originator and beneficiary. It is, however, possible for intermediaries to monitor transactions that they process to identify patterns of activity that may be suspicious, to report suspicious activities in such cases in accordance with their national law or local regulatory requirements implementing international standards, and, where such patterns or activities are associated with a particular correspondent bank, to review the relationship with the correspondent. Monitoring cover payments should not be understood as stretching or adding new obligations to existing Basel Committee and FATF standards for these intermediaries but only as being another case where pre-existing obligations apply.

C. The responsibility of beneficiaries' banks

32. The bank of the beneficiary must identify the beneficiary, and verify its identity, in accordance with the standards governing customer due diligence.²² The beneficiary's bank is also responsible for monitoring the activities of its customer, the beneficiary. Under the interpretative note to FATF SR VII, beneficiary's financial institutions should have effective risk-based procedures in place to identify wire transfers lacking complete originator information.

33. Consistent with the interpretative note to SR VII, transparency problems may be considered as a factor in assessing whether a wire transfer or related transactions are suspicious and, as appropriate, whether they are thus required to be reported to the financial intelligence unit or other competent authorities. In some cases, the beneficiary financial institution should consider restricting or even terminating its business relationship with financial institutions that fail to meet transparency standards. The reason for the decision taken should be documented.

D. Customer information and data protection issues

34. The transmission of customer data to third parties to execute a transaction, which is not unique to cover payments, should not raise specific data protection concerns. In any event, banks should comply with data protection laws and regulation. They should take the steps necessary with a view to ensuring that the information they receive and process is used only for the purposes permitted by national law and international standards and that adequate information is given to the customer. In particular any breach of confidentiality or any commercial use of this information should be precluded. Banks should commit to ensuring an adequate treatment of the information given and preclude its use for illegitimate purposes by themselves or any third party.

²² As stated in the interpretative note to FATF Recommendation 5: "The CDD measures set out in Recommendation 5 do not imply that financial institutions have to repeatedly identify and verify the identity of each customer every time that a customer conducts a transaction. An institution is entitled to rely on the identification and verification steps that it has already undertaken unless it has doubts about the veracity of that information." Examples of situations that might lead an institution to have such doubts are given.

E. Other issues

35. Consistent with the principles expressed by the Basel Committee in the document *Customer due diligence for banks*, the due diligence described in the previous sections should be taken into account in all relevant procedures, systems and controls, be part of the training of the relevant staff, and should be included in the scope of the bank's internal audit and compliance function.

36. In addition, unless adherence by their correspondents to appropriate transparency standards results from the participation in a messaging system, from local requirements or other equivalent mechanisms, banks should review their contractual documentation related to correspondent banking in order to ensure compliance with transparency standards and only enter into contractual relationships with banks adhering to transparency standards referenced to in paragraph 12.

III. The role of supervisors

37. As stated in the document *Customer due diligence for banks*,²³ "supervisors have a responsibility to monitor that banks are applying sound KYC procedures and are sustaining ethical and professional standards, on a continuous basis". In particular, supervisors must be satisfied that banks develop and implement appropriate policies, procedures and processes in their respective capacities as originator banks, intermediary banks in the cover payments chain, and beneficiary banks.

38. Supervisors may take several steps to assess their supervised institutions risk management practices with respect to cover payments. Supervisors should carefully review the risk management practices relating to those operations. Examples of steps that a supervisor may take to evaluate the risk management practices of a financial institution include:

- reviewing whether the institution has a current risk assessment that covers the payments activities, taking all relevant factors into account, including the correspondent relationships involved in the operations, the overall volume and jurisdictions of funds transfers and the role of the institution in funds transfers;
- determining whether the institution has implemented the transparency standards and maintains systems for consistent adherence to the transparency standards to ensure, for example, that banks do not use abbreviated message formats, such as interbank cover payments, to avoid scrutiny of originator and beneficiary information by correspondent intermediaries; supervisors should also be satisfied that originator banks include complete customer information in all cross-border wire transfers;
- evaluating whether the institution has processes for conducting adequate due diligence on correspondent banks that are also involved in cross-border clearing of cover payment transactions;
- reviewing the institution's processes in place for compliance with its national laws relating to transactions that must be blocked, rejected or frozen; and

²³ Basel Committee on Banking Supervision, *Customer due diligence for banks*, October 2001, paragraph 61.

- reviewing the institution's processes in place for compliance with applicable requirements for: inclusion of data on payment orders and maintenance of data for review; monitoring, reviewing, and reporting suspicious activity; and documentation of determinations made with respect to transactions and accounts.

39. Supervisors should be satisfied that appropriate internal controls are in place to monitor wire transfer activity, that these controls are effective, and that banks are in compliance with supervisory and regulatory guidance. As in other areas, the supervisory process would usually include not only a review of policies, procedures and processes but also the sampling of some transactions. The frequency and depth of any such supervisory reviews should match the level of risk. Supervisors should, when warranted, use their supervisory powers to ensure appropriate transparency practices are used.

40. When, in the course of their supervisory work or following reports from banks, supervisors become aware of significant failures to comply with transparency standards by banks in other jurisdictions, they should inform the relevant supervisor. Persistent difficulties should be brought to the attention of appropriate authorities.

Members of the AML/CFT Expert Group

Commission Bancaire, France	Mr Edouard Fernandez-Bollo, Co-Chairman
South African Reserve Bank	Mr Errol Kruger, Co-Chairman
Commission bancaire, financière et des assurances, Belgium	Mr Benoît Bienfait
Office of the Superintendent of Financial Institutions, Canada	Mr Nicolas Burbidge
Commission Bancaire, France	Mr Gaëtan Viillard
Deutsche Bundesbank	Mr Andreas Meissner
Bundesanstalt für Finanzdienstleistungsaufsicht, Germany	Mr Hans-Martin Lang
Hong Kong Monetary Authority	Mr Raymond Chan
Banca d'Italia	Mr Pierpaolo Fratangelo
Financial Services Agency, Japan	Mr Hideo Sato Mr Hideaki Kamei
Commission de Surveillance du Secteur Financier, Luxembourg	Mr Jean-François Hein
De Nederlandsche Bank	Mr Ashraf Khan
Saudi Arabian Monetary Agency	Mr Tariq Javed
Monetary Authority of Singapore	Ms Malkit G Singh
Banco de España	Mr Tomás García
Sveriges Riksbank	Mr Johan Fogel
Swiss Financial Market Supervisory Authority FINMA	Ms Geneviève Berclaz
Financial Services Authority, United Kingdom	Mr Philip Robinson
Federal Reserve Bank of New York, United States	Mr Jonathan Polk
Board of Governors of the Federal Reserve System, United States	Ms Nina Nichols
Federal Deposit Insurance Corporation, United States	Ms Lisa Arquette
Office of the Comptroller of the Currency, United States	Ms Susan Quill
European Commission	Mr Paolo Costanzo Mr Philippe Pellé
Financial Action Task Force	Mr John Carlson Ms Valerie Schilling
Offshore Group of Banking Supervisors	Mr Colin Powell
Financial Stability Institute	Mr Juan Carlos Crisanto
BCBS Secretariat	Mr Stéphane Mahieu Mr Sylvain Cuenot