

REGULATORY ALERT

**NATIONAL CREDIT UNION ADMINISTRATION
1775 DUKE STREET, ALEXANDRIA, VA 22314**

DATE: January 2010 **NO:** 10-RA-03

TO: Federally Insured Credit Unions

SUBJ: Interagency Guidance on Conducting Cross-Border Funds Transfers

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

Dear Board of Directors,

This Regulatory Alert is being issued to assist credit union compliance with the Office of Foreign Assets Control (OFAC) sanctions screening and transaction monitoring with respect to Bank Secrecy Act/Anti-Money Laundering requirements. This Alert addresses recent the changes in the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging standards which impact credit union compliance. The recently issued *Interagency Transparency and Compliance for U.S. Banking Organizations Conducting Cross-Border Funds Transfers* is included as an enclosure.

Cross-border cover payment transactions are used to execute international funds transfers where one or more financial institutions in the U.S. act in a correspondent capacity. A typical cover payment transaction involves the member instructing its credit union to make payment to the account of a payee at an international financial institution. The originator's credit union and the beneficiary's international financial institution do not have a relationship allowing them to settle the payment directly, so an account at a U.S. intermediary financial institution must be used to settle the payment. The intermediary financial institution receives an order to make a payment to the beneficiary's international financial institution, but does not receive the underlying information on the originator and the beneficiary of the funds transfer. The information regarding the originator and beneficiary is sent separately through the SWIFT messaging system.

The intermediary financial institution is unable to monitor or filter the payment details for OFAC compliance. As a result, they cannot assess the risk associated with the correspondent operations and monitor for suspicious activity. In the past, the SWIFT cover payment format has been used to deliberately conceal the parties to a particular transaction.

SWIFT changed its messaging standards as of November 21, 2009 to require the U.S. Originators' financial institutions to use the new payment transfer messaging format for cover payment transactions (MT 202 COV) for which there is an associated SWIFT MT 103 payment order.¹ The MT 202 COV contains mandatory fields for information relating to the originator and beneficiary of the transfer. This will increase the transparency of cover payment transactions by providing additional information regarding the originator and the beneficiary.

Consistent with current practices, credit unions should screen transaction information on all funds transfers and block or reject transactions as required by law and submit required reports to OFAC. The introduction of the MT 202 COV does not change U.S. sanctions obligations, but may increase the amount of information available to be screened. Credit unions acting as intermediary institutions should also conduct monitoring of funds transfers processed through their systems to identify suspicious activity.

If you have any questions regarding this guidance, please contact your district examiner, regional office, or state supervisory authority.

Sincerely,

/s/

Debbie Matz
Chairman

Enclosure

¹ The MT 103 is a specific SWIFT payment order messaging format used by credit unions when transferring money from their members to beneficiaries or financial institutions outside the United States.

**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).