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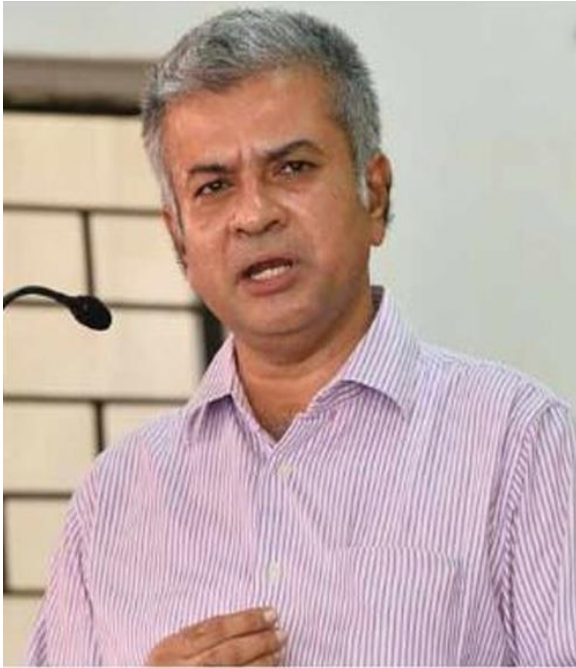
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## ***ABOUT US***

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provided dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

# **“SWIFT” DETERRENCE**

AUTHORED BY: TEJAS MADHAV JOSHI<sup>1</sup>

In reaction to the Ukraine invasion, the United States and its allies unilaterally decided to exclude the Russian Federation from accessing the Society for Worldwide Interbank Financial Telecommunications (SWIFT) on February 26, 2022.<sup>2</sup>

The purpose of this article is to give some information on many components of the SWIFT system, Russian suspension, and the impact on both the SWIFT and Russia.

The blog initially covers the nature and operation of the SWIFT, as well as its relevance in the global banking system, and then moves on to the issue of Russian expulsion.

## **What is SWIFT?**

Most international money and security transfers are powered by the Society for Worldwide Interbank Financial Telecommunications (SWIFT) system.<sup>3</sup> SWIFT is a massive communications network used by financial organisations to send and receive information such as money transfer instructions swiftly, correctly, and securely.<sup>4</sup>

SWIFT is a standardised coding system used by financial organisations to securely send information and instructions. SWIFT is not a financial entity, despite its importance to global financial infrastructure.<sup>5</sup> SWIFT does not own or transfer assets; instead, it enables safe and efficient communication among member institutions.<sup>6</sup>

In November 2022, more than 11,000 global SWIFT member institutions sent an average of 44.8 million messages per day across the network.<sup>7</sup>

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<sup>1</sup> Student at ILS Law College, Pune

<sup>2</sup> An Update To Our Message to SWIFT Community, SWIFT.

<sup>3</sup> Ripple and Swift slug it out over cross-border payments, Arnold, Martin (6 June 2018), Financial Times, From the Original on 27 September, 2019.

<sup>4</sup> SWIFT: Cooperative Governance for network innovation, standard and community, New York, Routledge, ISBN 978-1-317-90952-1, Scott, Susan V, Markos (2014).

<sup>5</sup> Ibid., pg 1-2

<sup>6</sup> Ibid., pg 1-2. 35

<sup>7</sup> SWIFT, Company Information, Original 22 Dec. 2008, as on 9 March 2010.

SWIFT is a member-owned cooperative that is governed by its shareholders (certain member financial institutions) and represents certain enterprises globally. SWIFT is governed by the G-10 central banks of the Group of Ten nations. Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States are among them. Belgium, together with other members such as the United States Federal Reserve, serves as the primary supervisor.<sup>8</sup>

Because all nations rely on SWIFT for rapid, seamless, and secure communication, they have an incentive to maintain good status with the organisation. SWIFT is overseen by central banks from the Group of Ten (G10) countries, although it is a neutral organisation that serves all of its members.<sup>9</sup>

## History

Telex was the sole accessible method of message confirmation for international financial transfers prior to SWIFT. Telex was plagued by low speed, security issues, and a free message format. In other words, unlike SWIFT, Telex did not have a standardised system of codes to designate banks and characterise transactions. Telex senders were required to describe each transaction in language that the receiver comprehended and carried out. This resulted in numerous human mistakes as well as delayed processing times.<sup>10</sup>

In the words of the London School of Economics, "Support for a shared network ... began to achieve institutional form ... in the late 1960s, when the Société Financière Européenne (SFE, a consortium of six major banks based in Luxembourg and Paris) initiated a 'message-switching project.'"<sup>11</sup>

To address these issues, the SWIFT system was established in 1973 with 239 institutions from 15 countries. As Worldwide Interbank Financial Telecommunication, with headquarters in Belgium, the worldwide network would send financial communications in a safe and timely manner. SWIFT's communications services became operational in 1977.<sup>12</sup>

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<sup>8</sup> Swift Board names new Chair and Deputy Chair, completing leadership transition, Company Information, 30 March 2023 and refer footnote 3, pp 16

<sup>9</sup> *ibid*

<sup>10</sup> History and Detailed Functioning of SWIFT, ECahiers de l'Institut. Graduate Institute Publications. 6 September 2011, ISBN 9782940415731

<sup>11</sup> Origins and Development of SWIFT, 19732009, Susan V Scott, Markos Zachariadis.

<sup>12</sup> Refer 9



## The structure of SWIFT

SWIFT gives a unique code of eight or eleven characters to each financial organisation, known as a bank identifying code or BIC. The BIC may also be referred to as a SWIFT code, a SWIFT ID, or an ISO 9362 number.<sup>2</sup> Consider the Italian bank UniCredit Banca, located in Milan, to better understand how the code is given. It is identified by the eight-character SWIFT code UNCRITMM.

**First four characters:** the institute code (UNCR for UniCredit Banca)

**Next two characters:** the country code (IT for the country Italy)

**Next two characters:** the location/city code (MM for Milan)

**Last three characters:** optional, but organizations use them to assign codes to individual branches.<sup>13</sup>

Remember that, as strong as SWIFT is, it is merely a communications system. SWIFT does not handle customer accounts or hold any cash or securities.<sup>14</sup>

SWIFT had grown to over 11,000 institutional members from over 200 countries and territories by 2022.<sup>15</sup>

Despite the existence of rival messaging systems such as Fedwire, Ripple, and the Clearing House Interbank Payments System (CHIPS), SWIFT remains the market leader. The platform's security, as well as the fact that it is constantly introducing new message codes to convey various financial activities, may be credited to its success.

Furthermore, while some nations utilise the International Bank Account Number (IBAN) to identify international bank accounts across national boundaries, the United States does not.<sup>16</sup>

Though SWIFT primarily started for simple payment instructions, it now sends various messages, including security, treasury, trade, and system transactions. In Swift's latest report from December 2022, data showed that most SWIFT traffic is still for payment (44%) and securities (51%) messages. The remaining traffic flows to treasury, trade, and system transactions.<sup>17</sup>

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<sup>13</sup> What is BIC? And ISO 9632, SWIFT website.

<sup>14</sup> Refer 9

<sup>15</sup> ibid

<sup>16</sup> Understanding IBAN and SWIFT: Essential Details When Making a Money Transfer, Currency Solutions, 2013

<sup>17</sup> Annual Review 2022, SWIFT.

## **Effects of removal/expulsion from SWIFT**

### **a. Impact on Russia**

The exclusion of Russian banks from SWIFT, along with other severe Western sanctions, has the potential to radically reorganize the Russian economy. After being kicked out of the SWIFT system for expanding its nuclear programme, Iran lost nearly half of its oil income and witnessed a 30% drop in global commerce in 2012.<sup>18</sup> Furthermore, when the US and EU threatened to cut Russia off from SWIFT in 2014, Russia's finance minister predicted that the move would result in a 5% decline in Russian GDP. Even if two of Russia's three major banks are still connected to SWIFT, there are alternate techniques for engaging globally that do not rely on SWIFT.<sup>19</sup> Nonetheless, Russia's economy is doomed.

Western sanctions prompted the Ruble's value to fall by more than 50% versus the dollar in 2014, resulting in a two-year reduction in GDP growth.<sup>20</sup> Since then, Russia has worked to further sanction-proof its economy by amassing \$600 billion in foreign reserves<sup>21</sup>, diversifying those reserves to include additional euros and renminbi, decreasing the national debt, and restricting imports of certain items. Despite these efforts, Russia remains strongly dependent on the dollar and Western markets. By the end of 2021, 16 percent of Russia's foreign reserves were in dollars, 32 percent in euros, and Germany, the Netherlands, and the United States were among its main trading partners.<sup>22</sup> These governments are now applying harsh sanctions.

### **b. Impact on Global Trade and Commerce**

With these countries now enforcing strict sanctions, Russia's economy is in a precarious position—one that is causing ripple effects across global markets including supply chain disruptions and higher prices on energy and agricultural goods.<sup>23</sup>

The United States' sanctions on Russia will have an especially large impact since the bulk of global commerce is conducted in dollars, and the United States has the ability to block any dollar transactions before they are finalized. Since the imposition of US sanctions, the ruble has lost about 30% of its value versus the dollar, and Russian bond prices have fallen as investors worry

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<sup>18</sup> Economic Diversification in Oil exporting Aran Countries, April 2016, prepared by IMF

<sup>19</sup> Ukraine conflict: What is Swift and why is banning Russia so significant? BBC, dated 4 May 2022.

<sup>20</sup> The impact of Western sanctions on Russia and how they can be made even more effective, Atlantic Council, dated 3 May 2021, by Ander Aslund and Maria Snegovaya.

<sup>21</sup> Russia's attempt to sanction proof its economy all in vain, The Economist, March 2<sup>nd</sup> 2022

<sup>22</sup> De-dollarization as a direction of Russia's financial policy in current condition, Xu Wenhong, National Library of Medicine.

<sup>23</sup> Press Conference, 9286<sup>th</sup> Meeting of Security Council, 17<sup>th</sup> March 2023

the country will be unable to satisfy its financial commitments.<sup>24</sup> Global supply systems are already under strain as a result of the COVID-19 pandemic's aftermath. Russia is a significant supplier of oil and gas, the world's largest producer of palladium and the world's second-largest producer of platinum—both of which are vital commodities in semiconductor manufacturing—and a major exporter of other critical minerals, mining commodities, and agricultural goods.<sup>25</sup>

#### c. Impact on Global Financial world

Russian banks' removal from SWIFT will further contribute to global reorientation of economic relationships

Russia's invasion of Ukraine, with no end in sight, is already hastening a wide global economic reorientation. Europe is expected to wean itself off Russian oil and gas, while Russia will be compelled to rely on non-Western-aligned countries for trade markets for the foreseeable future.<sup>26</sup>

## **Response by other countries**

Countries like China, India, and Turkey have all expressed an initial inclination to continue doing business with Russia, potentially widening the global economic gap between Western-aligned and Russian-aligned economies. These nations will still face trade restrictions as a result of sanctions and the SWIFT embargo, as well as the potential of secondary sanctions as a result of doing business with Russia. However, Russia's enormous resource reserves, as well as a desire to break away from the existing US-dominated financial system, may motivate them to maintain economic ties with Russia while moving further away from the West.<sup>27</sup>

#### **a. Chinese Response**

The extent to which China is ready to lure Russia into its economic orbit is unknown, particularly while the Ukrainian conflict continues on. China's foreign ministry first opposed Western sanctions against Russia and stated that regular commercial relations will continue. Russia is a significant supplier of crucial resources for China's long-term growth aspirations, such as energy supplies and critical minerals needed in semiconductor manufacture, as well as quickly expanding trade routes across the Arctic. During the early 2022 Beijing Olympics, China and Russia agreed in principle to increase bilateral commerce to \$250 billion by 2024, and trade between the two

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<sup>24</sup> Tumbling Ruble claws back ground as central bank to meet, Reuters, dated August 15, 2023.

<sup>25</sup> Supply of critical raw material endangered by Russia's war on Ukraine, OECD, dated August 4, 2022

<sup>26</sup> How cutting Russia from SWIFT will change financial landscape, Forbes, dated March 5, 2022.

<sup>27</sup> China is trading more with Russia- so are many US allies and partners, by Joseph Lipsky and Niels Graham, The Atlantic, May 30, 2023.

nations has increased to its highest level since the beginning of 2021. In the wake of deteriorating ties with the United States, China is unlikely to turn down the opportunity to improve its access to Russian resources and expand its area of economic influence.<sup>28</sup>

### **b. Indian Response**

India is now increasingly relying on Russia for energy imports, and it is currently considering opening rupee-based trading accounts with Russia.<sup>29</sup> In addition, Russia has been striving to expand its Eurasian Economic Union (EEU) free-trade zone, which already includes Vietnam in addition to Russia, Armenia, Belarus, Kazakhstan, and Kyrgyzstan.<sup>30</sup> Russia will become increasingly isolated from US and EU markets as Western sanctions take effect, but its enormous store of natural resources and strong linkages to China and Central Asia reduce the probability that it will become as economically isolated as North Korea or Venezuela. Instead, if the Ukrainian war persists and Western sanctions remain in place, commercial links with Russia might assist speed the establishment of a non-Western bloc in the global economy.

## **Alternatives to SWIFT by Russia and Iran**

The Russian version of the SWIFT money transfer system, designed by the Central Bank of Russia, is the System for Transfer of money Messages. Since 2014, when the US administration threatened to cut the Russian Federation from the SWIFT system, the system has been successfully developed.<sup>31</sup>

Iran has completely merged with SPFS on January 30, 2023, to aid improve trade and financial activities in an effort to circumvent tough economic restrictions on their financial infrastructure. With the signing of the deal, the SPFS now connects 52 Iranian and 106 Russian banks.<sup>32</sup>

## **Chinese Alternative to SWIFT**

To counter the dominance of CHIPS and SWIFT, China launched the Cross-Border Interbank Payment System, or CIPS, in 2015. The independent international yuan payment and clearing mechanism is used by CIPS to resolve international claims. Although it has the ability to build its own messaging network, it has been utilising SWIFT as its communication route since 2016.

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<sup>28</sup> Russia- China Relations and a Changing World Order, Dr. Himani Pant, Indian Council of World Affairs.

<sup>29</sup> India hopeful of Rupee trade with Russia after import surge by Rueter, dated

<sup>30</sup> The Growing relevance of Eurasian Economic Union for Russia, by Indian Council of World Affairs, dated 22<sup>nd</sup> December 2022

<sup>31</sup> Russia's SWIFT alternative expanding quickly this year, says central bank, Reported by Reuters, dated

<sup>32</sup> Iran – Russia Integrated banking system, by the Cradle, dated January 30, 2023.

CIPS phase one was signed up for by 19 institutions after its introduction in 2015, including Standard Chartered, Deutsche Bank, HSBC, and Citibank. According to the South China Morning Post, CIPS has 1,280 users in 103 countries in January 2022.

## **ACU's proposed alternative to SWIFT**

During a recent conference in Iran, members of the Asian Clearing Union (ACU) decided to develop a new cross-border financial messaging system in June to compete with the SWIFT international payment network.

Members of the ACU include the central banks of Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, Sri Lanka, Myanmar, and Iran, which is isolated owing to Western economic sanctions.<sup>33</sup>

## **Way Forward**

Excluding Russian banks from SWIFT, dubbed the "nuclear option," risks permanently undermining international financial integration and US currency hegemony. The broad acceptance and usage of a payment network's services determines its success and efficiency. When SWIFT restrictions were eased in 2014, Russia quickly developed its own communications network to support the local payment system. Russia has shifted its foreign reserve composition away from the US currency and expanded links with the Chinese Cross-Border Interbank Payment System (CIPS), which may pay international claims in yuan.

Over the last few years, China has established its own alternative international communications system as a preventive step against the rising risk of US-imposed financial penalties. Even the European Union, after the Iran nuclear agreement fell apart in 2018, began to establish its own financial messaging system, the Instrument in Support of Trade Exchanges (INSTEX), to avoid becoming entangled in the web of US-imposed sanctions on Iran. The SWIFT cutoff may also stimulate wider usage of cryptocurrencies to avoid banking restrictions, as seen by their remarkable appreciation on Monday, February 28 amid global volatility. Nonetheless, the last several years' experience shows that these fears are overblown, as the US dollar remains the cornerstone of the international financial system.

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<sup>33</sup> ASU reportedly to launch alternative to SWIFT, The Global Times, dated January 2, 2023