SWIFT Messaging System

Why in News?

Recently, the US and the European Commission has excluded several Russian banks from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging system to counter Russia’s war over Ukraine.

What is SWIFT?

- It is formally known as the Society for Worldwide Interbank Financial Telecommunication (SWIFT).
- It is a trusted messaging system for banks and other financial institutions around the world.
- It doesn’t settle any money itself, but provides instruction messages for just how to give and receive specific funds.
- It is controlled by the central banks of the G10 countries, the European Central Bank, and the National Bank of Belgium.
  - It was established in 1973 and is based in Belgium.
  - The Group of Ten is made up of eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) which consult and co-operate on economic, monetary and financial matters.
- Prior to SWIFT, the only reliable means of message confirmation for international funds transfer was Telex.
  - It was discontinued due to a range of issues such as low speed, security concerns, and a free message format.
- There are about 11,000 member banks in 200 countries and territories that use SWIFT.
  - Since it began in 1973, SWIFT has become an integral part of the flow of global trade.
  - India’s financial system has access to the SWIFT.
- Iran and North Korea are already out of the SWIFT platform.

How does SWIFT work?

- An important component of the SWIFT messaging system is the SWIFT code.
  - Each bank that participates in the system is assigned this code, which identifies the bank, the country it’s in, where it’s located in the country, and, optionally, the branch.
  - It has 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.
  - When a bank is a member of SWIFT, their instruction messages are cleared as secure immediately, so the transactions happen quickly.
How can the SWIFT Sanctions Impact Russia?

- Banning a bank from SWIFT will technically impede the excluded bank from executing its and its customers’ financial transactions with foreigners, meeting obligations, receiving payment for exports, or providing short-term credit for imports.
- This can paralyze all sectors of the economy engaged in international trade and finance.
- Russia’s domestic payment system could also be disrupted to the extent that all transactions with any card issued by the major credit card networks (VISA, Mastercard, Amex, etc.) all operate through SWIFT.
- Russian citizens would find traveling abroad much more cumbersome without access to credit cards.
- The sanctions pose risks for those countries that have imposed them and the broader global economy.
  - Disruptions to Russia's financial system could disrupt the energy supply to Europe, as well as commodity exports to global markets, triggering further increases in energy and food prices that were already elevated due to COVID-19, supply shortages, adverse weather shocks, and supply chain disruptions.

What are the Alternatives of SWIFT?

- **SPFS (System for Transfer of Financial Messages)** is a Russian equivalent of the SWIFT financial transfer system, developed by the Central Bank of Russia. It was established by the Russian central bank after the 2014 invasion of Crimea.
  - The financial messaging system of the Bank of Russia (FMS) forms an alternative electronic financial messaging channel which is often called a ‘SWIFT analogue’.
  - The FMS guarantees the uninterrupted transmission of financial messages within the country.
- China also has an alternative to SWIFT called the **Cross-Border Interbank Payment System (CIPS)**.
  - But CIPS is much smaller, with roughly 1,300 financial institutions participating, most of them indirectly.
- There are financial technology companies like **Ripple**, which has been offering its platform based on interledger protocol (the same technology behind cryptocurrencies) as an alternative.
- **Cryptocurrencies** are another avenue for cross border remittances. Russia has also been working on a 'digital' rouble, which is still not launched.

What could be the Impact on India?

- India may witness some cancellations of supply orders by the Russians; domestic exporters, too, may choose to cancel some.
  - If all Russian banks are ousted from the SWIFT network, payments will get delayed and ultimately hit trade.
- Since India has a trade deficit with Russia, in certain cases, a barter system can also be activated easily.
  - Given the trade deficit, impact on India will ultimately be limited.
  - India mostly buys petroleum products, diamonds and other precious stones and fertilisers from Russia. Similarly, it ships out capital goods, pharmaceutical products, organic chemicals and auto parts to Moscow.
- **Alternative Mechanism for India:**
  - India can adopt a mechanism that can be modeled on the rupee-rial architecture that was used to clear payments to domestic firms when the US imposed sanctions on Iran.
Under the rupee-rial mechanism, Indian refiners used to import crude oil from Iran and make payments to the designated rupee-account at Uco Bank and IDBI Bank. This money was, in turn, used to pay Indian exporters. This continued until crude oil was in the exempted list of US sanctions.

Following the collapse of the Soviet Union in 1991, India had entered into a rupee-rouble trade arrangement with Russia to ensure that defence and other imports could continue.

In 2018, a pilot project was run where Indian importers paid in roubles for diamond imports. These payments were made to the Indian branch of Russia's Sberbank. SBI and Canara Bank have a joint venture (The Commercial Indo Bank), which might be able to help Indians there.

What is IFSC Code?

- The Indian Financial System Code (IFSC) is a unique 11-digit alphanumeric code that is used for online fund transfer transactions done via NEFT, RTGS and IMPS.
- The Reserve Bank of India (RBI) assigns the IFSC codes to the bank.
- In case you are using net banking to transfer money, it is mandatory for the IFSC to be entered to initiate the transfer.
  - Every bank branch will have a unique code and no two branches (even of the same bank) will ever be the same.
  - Unless there is a merger, banks do not modify or change the IFSC code.
- **IFSC code format**: The first 4 digits of the IFSC represent the bank and the last 6 characters represent the branch. The 5th character is zero.

What is MICR Code?

- Magnetic Ink Character Recognition (MICR) is a 9-digit code that helps identify a particular bank branch that is part of the Electronic Clearing System (ECS).
- This code can be found on the cheque leaf that is issued by the bank and is generally printed on the passbook that is issued to the account holder.
- The main purpose of the MICR code is to clear cheques that are deposited in machines. The code helps in avoiding errors as well.
- **MICR Code Format**: The first three digits of the code represents the city, the next three digits represent the bank code, and the last three digits represent the bank branch code.