

Should Russian Banks Be Scared of SWIFT Disconnection?

Talk of financial Armageddon should Russia be kicked out of the system may be overblown.

By Jake Cordell

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Calls for Russia to be disconnected from SWIFT have grown in recent weeks. Alexander Demianchuk / TASS

Ukraine has joined the chorus of voices calling for Russia to be disconnected from SWIFT — the financial messaging network that underpins the global banking system.

In a meeting with EU foreign ministers, Ukraine's top diplomat Dmytro Kuleba said he had <u>called</u> for a tough new package of sanctions, including the expulsion of Russian banks from the Society for Worldwide Interbank Financial Telecommunications (SWIFT) network, which currently links more than 11,000 banks operating in at least 200 countries and territories around the world.

The proposal — long popular among those who favor slapping hard-hitting sanctions on Russia — has picked up new supporters since last year's poisoning of Alexei Navalny. Talk of a <u>possible embargo</u> reached fever pitch in Moscow in the days leading up to U.S. President Joe Biden's announcement of a new <u>round of sanctions</u> against Russia mid-April, with top Russian officials and banking figures talking up the dangers of being disconnected.

"We cannot rule out any potential threats," Kremlin spokesperson Dmitry Peskov said last month when asked about the possibility. "Sanctions are unreasonable and unpredictable and therefore the situation forces us to be alert," he added.

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Those comments kick-started a frenzy of speculation about what Russia would do in the event of a shutdown.

The Foreign Ministry said Russia needed to create its own blockchain-based <u>alternative</u>. The head of Russia's banking association warned SWIFT against disconnecting Russian lenders, saying it would be an act of "<u>self-castration</u>," while the Director General of the Kremlinaligned Russian International Affairs Council (RIAC) compared the potential move to detonating a financial "<u>nuclear bomb</u>."

But experts say the chances of Russia being disconnected are slim, and the likely impact, while serious, could be being overblown.

'Red herring'

"Russia is painting it like it would be financial warfare, and frankly I don't get that," said Brian O'Toole, a senior fellow at the Atlantic Council and former adviser to the U.S. Treasury's Office of Foreign Assets Control (OFAC), the department which administers and enforces U.S. sanctions around the world.

He called disconnecting Russian banks from SWIFT a "red herring" and suspects it stems from a "huge misunderstanding" of what the network actually does.

The system, which facilitates secure and fast communications between financial institutions is often mislabeled a "payments system," but it is actually a notification and communications network.

"SWIFT is a messaging service, essentially. Money doesn't actually flow over the SWIFT network, which is what many people don't realize," O'Toole said.

"If Russia was disconnected from SWIFT today, there would be a big impact, let's not minimize that. But taking them off doesn't cut them off from U.S. banks, because Russian institutions can use Telex or another form of financial messaging. There's too much economic activity at stake for those banks not to fall back on other methods," he added.

While officials have talked up the dangers of disconnection, some Russian analysts have also brushed off the long-term implications of being kicked-off SWIFT.

"By itself, disconnecting Russian banks from SWIFT means only increasing the cost and slowing down financial transactions," said Oleg Bogdanov, lead analyst at investment company QBF. "The traditional connections will be broken, and it will take some time to restore them. But it can be done in a week or two."

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Russia's Central Bank has also <u>downplayed</u> the risks of a possible disconnection.

Western calls, from advocates and politicians for the U.S. to take measures are also misguided, since SWIFT is headquartered in Belgium, and the U.S. has no jurisdiction over the organization — as the company itself states in an <u>announcement</u> about sanctions on its website. Any action would therefore require new steps by the EU, which is hostage to a potential veto by any one of its 27 members. For instance, despite Washington's decades-long financial sanctions against Iran, Iranian banks were only disconnected from the SWIFT network in 2012, as the result of EU measures.

While talk of financial Armageddon should Russia be disconnected may be overblown, most analysts agree disconnection from SWIFT would still be painful.

"Cutting Russia from the SWIFT payments system would present significant adverse implications for the investment environment and exporting sector of Russia," Scope Ratings director Jakob Suwalski told The Moscow Times.

Domestic alternative

Russian banks would be forced to use alternatives, perhaps having to convince their counterparts to sign up to a Russian system just for them — a significant inconvenience — or incurring the cost of using friendly intermediaries. These could be banks in Belarus or other members of the Eurasian Economic Union, which are connected to both SWIFT and Russia's home-made alternative, the Central Bank's System for Transfer of Financial Messages (SPFS).

To date, SPFS has been heavily promoted at home but failed to receive much pick-up abroad. Developed in 2014, it has more than 400 domestic users — practically every licensed Russian lender — but only a handful abroad. Despite a shared desire to reduce the dominance of western systems in the global economy and their diplomatic friendship, China is notably cool on the idea — with only <u>one Chinese bank</u> signed up to SPFS — preferring its own Chinese alternative.

While Russia's SPFS can be three times cheaper than SWIFT, the network itself also has serious limitations. It is only operational during weekday working hours, unlike SWIFT which works 24/7. Messages are also limited to 20kb in size, while SWIFT allows 10mb to be transmitted across its network.

Despite traffic doubling in 2020 to two million messages a month, the domestic system accounts for only a fifth of all financial messages, the Central Bank said. It wants to <u>boost</u> its share to a third by the end of 2023. Meanwhile, Russian banks remain among the world's most

active users of SWIFT.

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The Russian banking system, therefore, sees SPFS as a last resort, <u>according</u> to Gennady Salych, chairman of the Freedom Finance bank. "SPFS is a tool for banks in the case of war, blackout or cyberattack on SWIFT's infrastructure," he said.

Given these drawbacks, Russia's heavy use of SWIFT and its multibillion dollar export transactions, particularly in oil and gas, disconnection would undoubtedly be "painful," said Scope analyst Levon Kameryan.

However, it could also be a significant boost to SPFS and accelerate the Russian government's post-2014 attempts to reduce its reliance on western payments infrastructure.

"While painful in the short-run for the Russian economy, [disconnection] could accelerate the government's steps to promote a more multipolar, less dollar-centric global order," Kameryan said.

But O'Toole, a former sanctions advisor to the U.S. government, says talk of a cut off is premature.

"Disconnecting from SWIFT is the last thing you do — or the last thing you try to do — from a sanctions perspective. In the case of Iran, disconnection took them from 92% to 97% on the pain meter."

On the same scale he would put Russia at around 10% — leaving lots of ground to cover, such as a full ban on owning Russian government debt, more restrictions on state-owned companies, and then "working up to actually blocking transactions with a Russian bank or two" before Western governments would move to block SWIFT.

"That's what gets you to 60 or 70% on the pain meter. Blocking Sberbank, for instance, would be a much bigger deal than SWIFT. That would be real financial warfare."

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