

# Society for World Interbank Financial Telecommunication System (SWIFT)

May 24, 2019

## Manifest Pedagogy

SWIFT, NEFT, RTGS, RUPAY and other terminologies are important for prelims and mains. Moreover, the misuse of such instruments and precautions one needs to take in order to prevent frauds and what is being done by the government in this regard may add value as part of your answers.



## In news

Nirav Modi scam

## Placing it in the syllabus

Banking Sector Reforms

## Static dimensions

- What is SWIFT?
- Problems with International payments
- FEMA Act
- Hawala

## Current dimensions

- Need for reforms and established procedure in swift
- Letter of Understanding vs Letter of Credit

# Content

## What is SWIFT?

It is a member-owned cooperative that provides safe and secure financial transactions for its members. **Established in 1973**, SWIFT uses a standardized proprietary communications platform to facilitate the transmission of information about financial transactions. Financial institutions securely exchange this information, including payment instructions, among themselves.

SWIFT neither holds funds on its own nor manages external client accounts. The cooperative began operating in 15 countries in 1973 and now operates in 210 countries, linking more than 10,000 financial institutions.

The SWIFT is a secure financial message carrier – in other words, it transports messages from one bank to its intended bank recipient.

Its core role is to provide a secure transmission channel so that Bank A knows that its message to Bank B goes to Bank B and no one else. Bank B, in turn, knows that Bank A, and no one other than Bank A, sent, read or altered the message en route.

## Foreign Exchange Management Act

- It was enacted to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.
- It makes offences related to foreign exchange civil offenses.
- The act enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organization (WTO).

## **Hawala**

It is a method of transferring money without any money actually moving. Hawala is an alternative remittance channel that exists outside of traditional banking systems. Transactions between hawala brokers are made without promissory notes because the system is heavily based on trust and the balancing of hawala brokers' books.

## **Problems with International payments**

1. A total of 44 Indian banks are subscribers of SWIFT's messaging services which is a secure line to send information domestically and internationally between banks. However, 19 of these banks have been fined a combined Rs.40 crore by the RBI for non-compliance of SWIFT norms.
2. The non-compliance might be due to banks not automating their protection chain and other internal reconciliations.
3. Further, Banks are not following the mandatory principles to be followed by them.
4. When it comes to Nirav Modi and PNB case, PNB's SWIFT network was not connected with its Core Banking System (CBS) and hence the fraudulent payment wasn't detected both by the bank and SWIFT in its immediate aftermath. Post the PNB fraud, RBI had mandated all banks using SWIFT channel to connect their core banking system with the channel. The regulator later conducted audits on these financial institutions and had issued them show-cause notices after they found varying degrees of non-compliance. This led ultimately to the central bank fining 19 banks as a rap on their knuckles to up their game and become SWIFT compliant to avoid a PNB-style dupe.

## **Letter of Understanding vs Letter of Credit**

### **Letter of undertaking (LOU):**

- It is the provision of bank guarantees known as a letter of undertaking (LOU) under which a bank can allow its customer to raise money from another Indian bank's foreign branch in the form of a short term credit. The LOU serves the purpose of a bank guarantee for a bank's customer for making payment to its offshore suppliers in the foreign currency.
- To raise the LOU, the customer (importer) is supposed to pay margin money to the bank that issues the LOU and accordingly, they are granted a credit limit.

### **Letter of credit:**

- It is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make a payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.
- Due to the nature of international dealings, including factors such as distance, differing laws in each country, and difficulty in knowing each party personally, the use of letters of credit has become a very important aspect of international trade.

### **Need for reforms and established procedure**

In the light of Nirav Modi case, it is necessary to bring the following reforms in the SWIFT;

- Integration of the international bank transfers protocol, Society for Worldwide Interbank Financial Telecommunications (SWIFT), with the core banking system
- Shore up modern arm's-length finance and the corporate bond market together with insurance products like credit default swaps as a recourse to bond defaults, speed up bankruptcy resolution generally, and make electoral

funding more transparent.