

*SWIFT – Too Many “Known Unknowns”?*

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SWIFT has been coming up in many conversations over the past few weeks and that frequency has intensified.

We know that D.C. has spoken to many big banks, but while Academy hasn't, we try to present what we are hearing and seeing on the potential for cutting Russia off from SWIFT.

SWIFT is overseen by the G10 central banks — Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Great Britain, the United States, Switzerland, and Sweden — as well as the European Central Bank.

### Potentially Punitive

It would be punitive and effectively shut the Russian economy off from the dollar. That would be punishing. It would make access to wealth difficult. It would potentially grind commerce to a halt. Over time it would drain the Russian economy of much needed money.

### Known Unknowns

The problem with this is that there are a lot of "known unknowns" and potential pitfalls.

Shutting off access to SWIFT may have a lot of ramifications that only become apparent after the fact. In many ways, letting **Lehman** go bankrupt created problems that few expected. There were entities all over the globe that were part of the Lehman legal entity chain. Some less obvious ones (along with some less obvious business lines) caused some of the problems that plagued markets in the aftermath. Not all of these were well understood going into the bankruptcy. I'd argue that some of the “obvious” problems of a Lehman bankruptcy were well handled. However, surprises in the complex system that weren't identified or were underestimated caused the problem. That could be the same sort of chain reaction from shutting Russia out of SWIFT.

One specific example that has come up, is **US Dollar denominated Russian bonds**. If payment isn't possible due to being locked out of SWIFT, does that trigger events of default on those bonds? If that is the case, what are the implications for banks or insurance companies that hold them? Regulatory treatment? Accounting treatment? Etc.

**Russian CDS** (credit default swaps) were trading in the low 100's for most of January, were at 200 last week, and spiked to over 900 at 11:30 am today (their widest levels). Sovereign CDS is always a bit technical, but that is a meaningful move and in line with the Russian stock market which was down as much as 50% at one point early this morning.

The potential for shutting down SWIFT for Russia seems to carry a big risk of triggering unintended consequences for companies doing any business with Russia and especially for banks and financial institutions. Could the consequences to us be severe?

I am sure that people with more detailed knowledge are digging into these issues, but from my conversations and perspective, these risks are real.

### Will It Even Be Punitive?

In a country with wealth so concentrated, how effective is it? If you have billions of dollars' worth of

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assets, so much money you can't spend it in your lifetime, do you care if you can't access some portion of it?

As we've argued from the beginning, we should assume all of Putin's cronies and every wealthy person in Russia who isn't one of his cronies (to the extent they exist) would be prepared for sanctions. Maybe not a SWIFT shutoff, but then again, maybe?

What if China helps get around sanctions? Their demand for raw resources is almost insatiable and maybe they would be happy to see more global commerce (even if just between them and Russia) to be outside of SWIFT (assuming they can do that).

How does crypto fit in? Does crypto help avoid SWIFT, at least for some period of time and for some amount of money?

### **Reserve Currency Status**

Also, and this is a bit more "theoretical", but it could impact the US Dollar's status as the world's reserve currency. Once you block access, those who want change will focus on that. I'm not very worried about this, but it would be an argument used by China to give their currency more credibility. I view this as a very minor reason not to proceed on SWIFT, but a reason nonetheless.

### **Bottom Line**

We may cut Russia off from SWIFT, but virtually everyone we talk to seems more worried about triggering unintended problems for us relative to how effective it might be.

I would view shutting Russia off from SWIFT as a significant “risk-off” trigger.

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