New Swift Rules on the Liability of Financial Institutions for Interest Losses Caused by Delay in International Fund Transfers

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NEW SWIFT RULES ON THE LIABILITY OF FINANCIAL INSTITUTIONS FOR INTEREST LOSSES CAUSED BY DELAY IN INTERNATIONAL FUND TRANSFERS

Financial institutions greatly expanded their international activities in response to the growth of multinational corporations since World War II. Specifically, the number and value of international fund transfers have increased significantly. The three traditional methods of transferring funds to a foreign country are bank draft, air mail transfer, and cable transfer. Of the three, cable transfer is best for high dollar-value transfers because financial institutions can effect payments with great speed, thus cutting down on the float.

In 1973, a group of financial institutions formed the Society for Worldwide Interbank Financial Telecommunications (SWIFT) to effect international fund transfers more efficiently. The SWIFT network is an improvement over individual cable or telex systems because it allows financial institutions to send funds quickly to many banks, including those with which they do not have a correspondent relationship, at a greatly reduced cost. Despite the advantages of the network, problems arose with respect to interest losses resulting from delays in effecting payments after

2. To transfer funds by bank draft, the customer purchases a bank draft drawn on the bank's foreign correspondent. The bank or customer then sends the draft to the beneficiary and the bank notifies its correspondent of the sale of the draft. The beneficiary, upon receiving the draft, presents it to the foreign correspondent for payment. Harfield, Elements of Foreign Exchange Practice, 64 Harv. L. Rev. 436, 442-43 (1951). To transfer funds by cable or air mail, the customer and the bank contract for the bank's creation of a credit in the foreign country. The purchaser pays the bank, which in turn writes or cables its foreign correspondent, instructing it to create credit on behalf of the designated beneficiary. Id. at 441-42.
3. See Trolle-Schultz, International Money Transfer Developments, 9 J. Bank Research 73, 75 (1978) for data comparing the speed of bank drafts, mail transfers, and cable transfers.
4. “Float” refers to the time period during which a payer retains the use of funds that he has sent to a third person. One study defined the float as “[f]unds which have been credited to one account before they have been debited from another account, and therefore are temporarily credited to two accounts.” Arthur D. Little, Inc., The Consequences of Electronic Fund Transfers 242 (1975) (emphasis in original).
5. See New SWIFT Network Gives Banks an Instantaneous Link-Worldwide, 69 Banking 48, 48 (June 1977) [hereinafter cited as New SWIFT Network].
6. Id.
financial institutions sent messages through the SWIFT network. The original SWIFT guidelines and general case law failed to define clearly the responsibilities and liabilities of member institutions. To settle the disputes, the directors of SWIFT adopted a set of rules in February, 1979, that define the responsibilities and liabilities of the participants in the network.

This Note will analyze the effect of the new SWIFT rules on the liability of financial institutions for interest losses caused by delay. First, the Note will discuss the mechanics of international fund transfers and the case law that developed to govern them. Second, it will outline the new SWIFT rules and analyze their effectiveness. Finally, the Note will explore important issues that the SWIFT rules fail to address.

I

INTERNATIONAL FUND TRANSFERS

A. OPERATION

An examination of the method by which financial institutions effect traditional international transfers facilitates an understanding of the SWIFT system.

I. Traditional Transfers

There are four participants in a traditional international transfer: the customer who wishes to make a payment, the transmitting bank, the receiving bank, and the beneficiary who is to receive the payment. To effect an international fund transfer, the transmitting bank must have a correspondent bank relationship with the receiving bank. That is, the transmitting bank and receiving bank must maintain foreign currency accounts with each other. Financial institutions refer to these accounts as "nosto" and "vostro" accounts.

To make an international payment, the customer first instructs the transmitting bank to make a payment to a specified beneficiary in another country. The transmitting bank debits its nostro account and credits the receiving bank’s account. It then mails a letter or transmits a cable or telex message to the receiving bank instructing the latter to complete the payment. The receiving bank credits its nostro account and debits the transmit-

8. "Nosto" account means "our account with another institution." Thus, Bank A’s nostro account reflects the number of German marks that it maintains on deposit with its German correspondent. "Vostro" account means "your account with us." Thus, Bank A’s vostro account reflects the number of U.S. dollars that the German correspondent bank maintains on deposit with Bank A. Id. at 42.
9. Harfield, supra note 2, at 441-42.
ting bank's account. If the beneficiary has an account in the receiving bank, the bank credits that account. Otherwise, the receiving bank transmits the funds to the beneficiary or to the beneficiary's bank of deposit.

2. SWIFT Transfers

Financial institutions formed the SWIFT message switching network to cope with the growing volume of international payments and the deterioration of mail services. The advantages of the SWIFT network are speed, volume, security, economy, and the use of uniform formats. Member banks own the share capital and share the operating costs according to message volume and number of terminals. Any bank involved in international payments may become a member of SWIFT.

SWIFT is only a communications or message switching network, not a settlement system such as the New York Clearing House Interbank Payment System (CHIPS). SWIFT members must still effect settlement through the use of correspondent account relationships. Member banks

10. Id.
11. G. Schneider, supra note 7, at 43.
12. Id.
13. NCEFT, supra note 1, at 72. In 1971, sixty-eight banks from eleven countries in Europe and North America attended the first meeting that resulted in the commission of a feasibility study and the creation of project committees. The feasibility study concluded that financial institutions needed a computerized system to replace slower mail and telex services. SWIFT as a nonprofit cooperative society under Belgian law. Id. SWIFT began operations in May, 1977. Id. SWIFT now includes nearly 700 financial institutions in 26 countries and, in terms of transaction volume, is the largest network of its kind. SWIFT Codifies Liabilities, American Banker, June 18, 1979, at 1, col. 3. The other major money transfer networks in the United States are the Federal Reserve Communication System (Fed Wire), Bank Wire, the New York Clearing House Interbank Payments System (CHIPS), and the National Automated Clearing House Association (NACHA).
14. Priority messages can arrive in under one minute; normal messages arrive in less than ten minutes. New SWIFT Network, supra note 5, at 48.
15. Id. Message volume is approaching 200,000 items per day. SWIFT U.S. Center to Start Up in Feb., American Banker, Dec. 4, 1979, at 3, col. 3.
16. Special coding and authentication of messages provide two levels of security. New SWIFT Network, supra note 5, at 48.
17. One major bank calculated the cost per message to be at least one-fifth the cost of sending a message without SWIFT. Id.
18. All messages are transmitted in standard formats and in English. Id.
20. NCEFT, supra note 1, at 73. This includes central banks, savings and loan associations, trust companies, and commercial banks. Id.
21. In the CHIPS system, the network's central clearing house keeps a record of messages and at the end of each day determines the net debits and credits of each member bank with the other member banks. The clearing house transmits summary reports to each member bank.
need not, however, have correspondent relationships with every other member in order to send messages to all members.

The participants in a SWIFT transaction are the customer, the transmitting bank, the concentrators, the switching center, the receiving bank, and the beneficiary. The transmitting bank sends a message from its terminal, which is connected to a concentrator, to the switching center. This transmission includes the input sequence number, the transmitting bank’s code number, the receiving bank’s code number, the name and address of the person to whom the funds are to be transferred, the amount of the transfer, the date on which the receiving bank obtains the use of the funds (value date), and the date on which the receiving bank or a third bank must make the payment to the beneficiary (pay date). The transmitting bank then debits its nostro account. The switching center acknowledges the message and transmits it to the receiving bank. The receiving bank must sequentially identify each message that it receives. If the beneficiary who is to receive the money has an account with the receiving bank,

and, on the next business day, sends a copy of this information to the Federal Reserve Bank of New York. NCEFT, supra note 1, at 71-72. Since SWIFT is only a message switching network, however, it does not provide settlement services and each member bank must balance its accounts with correspondents. Someday SWIFT might interface with a settlement system such as CHIPS or Fed Wire. See Fed May Link Transfer Net to CHIPS, American Banker, Nov. 16, 1979, at 1, col. 4.

22. Concentrators connect member banks in each country to the switching centers. New SWIFT Network, supra note 5, at 49.


Private leased (dedicated) telecommunications lines connect the concentrators to the switching centers. Using dedicated lines enables the member banks to exert full control over transmissions and enables SWIFT to assume responsibility for message accuracy and delivery. Trolle-Schultz, supra note 3, at 73-74. In Europe, SWIFT leases its communications lines from government-owned Postal, Telephone, and Telegraph Agencies (PTTs). NCEFT, supra note 1, at 70.

24. SWIFT requires members to number messages in sequential order for security purposes. INT’L SAVINGS BANK, supra note 19, at 40.


26. The transmitting bank’s nostro account reflects the amount of currency that it maintains on deposit with its foreign correspondent, the receiving bank. See note 8 supra. For a discussion of the procedure in situations in which the transmitting bank does not have a correspondent account relationship with the beneficiary’s bank, see text accompanying note 29 infra.

27. If the transmitting bank desires to revoke the payment through the SWIFT system, it must retrieve the message before it leaves the switching center. If the switching center has already transmitted it to the receiving bank, the transmitting bank can only revoke the payment by contacting the receiving bank through another medium before the value date. Telephone interview with W. Robert Moore, U.S. Director of SWIFT (Sept. 16, 1979).

28. INT’L SAVINGS BANK, supra note 19, at 40. See also note 30 infra.
the receiving bank must debit the transmitting bank's account on the value date and credit the beneficiary's account on the pay date. If the beneficiary does not have an account with the receiving bank, the receiving bank must transfer the funds to a third bank that maintains the beneficiary's account. The third bank must credit the beneficiary's account by the pay date. This latter situation arises when the transmitting bank does not have a correspondent account relationship with the third bank and must use the receiving bank as an intermediary.

Despite the security measures built into the SWIFT system, a risk of delay exists in the transmission or receipt of messages that might result in a loss of interest. In fact, since SWIFT began operations in 1977, members have sustained interest losses resulting from the failures of transmitting banks, switching centers, and receiving banks "to adhere to the rules and the co-operative intent of [SWIFT]." Whenever delay causes member financial institutions to sustain interest losses, it becomes necessary to allocate responsibility and liability among the financial institutions and SWIFT.

B. LEGAL FRAMEWORK PRIOR TO SWIFT RULES

No statute governs commercial international fund transfers or domestic interbank transfers. Thus, judicial doctrine plays an important role in allocating the risks of loss caused by delay in international payments.

1. Case Law

The case law governing international transfers revolves around five major issues: the applicable law, the nature of the legal relationship between the transmitting bank and the receiving bank, the standard of care

29. SWIFT Board Paper 185, Special Newsletter: Responsibility and Liability § 2(b) (Apr. 1979) [hereinafter cited as Board Paper 185].
30. Security precautions include the use of encoded messages and log-in procedures, and the sequential identification (individual testing and authentication) of each message by the receiving bank. See New SWIFT Network, supra note 5, at 49; Int'l Savings Bank, supra note 19, at 40.
and liability, the amount of recovery, and the time of payment. Since no cases involving SWIFT have been litigated, it is necessary to look at the existing case law in analogous transactions. The following discussion focuses on U.S. case law.

The legal rights and liabilities of the participants vary depending on the forum involved and the law applied in a given situation. The courts disagree on the applicable law, but most jurisdictions apply one of two conflict of laws rules. Under the first rule, the law of the place where the customer paid for the credit transfer governs. In most cases, this will be where the parties entered into the contract. The second rule treats cable transfers as executory contracts, and the law of the place where the contract is to be performed governs. The place of performance is the country or state in which the transmitting bank must create the credit for the beneficiary.

The characterization of the legal relationship between the transmitting bank and the receiving bank often depends on the nature of the relationship between the customer who wishes to make a payment and the transmitting bank. The courts generally characterize the customer-transmitting bank relationship as one of agency in which the customer (payer) is the principal and the transmitting bank is the agent. As an agent, the transmitting bank must act in good faith and exercise ordinary care under the circumstances. Thus, if the transmitting bank delays in setting up the credit, it may be liable to the customer for breach of contract.

Depending on the jurisdiction, courts characterize the receiving bank

34. See generally Annot., 69 A.L.R. 673 (1930); Annot., 45 A.L.R. 1052 (1926); Annot., 27 A.L.R. 1488 (1923); 6 A. Michie, Banks and Banking ch. 12, §§ 3-12 (rev. perm. ed. 1975); 7 C. Zollmann, Banks and Banking ch. 172 (1938); 10 Am. Jur. 2d Banks §§ 311-319 (1963); 9 C.J.S. Banks and Banking § 172 (1938).

35. A SWIFT transaction is functionally equivalent to a cable transfer or air mail transfer in that all involve a direction to a foreign correspondent to set up a credit for, or to make a payment to, a specified person.

36. See American Union Bank v. Swiss Bank Corp., 40 F.2d 446, 450 (2d Cir. 1930).


39. See Gage v. Boston Nat'l Bank, 257 Mass. 449, 452, 154 N.E. 74, 75 (1926). A few courts also used the trust theory, under which the transmitting bank acts as trustee on behalf of the customer. See, e.g., State v. Grills, 35 R.I. 70, 85 A. 281 (1912). Most U.S. jurisdictions have rejected the trust theory on the grounds that the transmitting bank does not agree to transmit a specific packet of money, but rather to create a credit in a foreign bank. See A. Michie, supra note 34, at ch. 12, § 3; Crawford, Credit Transfers of Funds in Canada: The Current Law, 3 Canadian Bus. L.J. 119, 124-25 (1979).


as either an agent\textsuperscript{42} or a subagent\textsuperscript{43} of the customer. If the court considers the receiving bank a subagent, the transmitting bank might be liable to the customer on three grounds. First, the transmitting bank may be liable if it fails to use due care in selecting the receiving bank.\textsuperscript{44} Second, the transmitting bank may be liable for the receiving bank's failure to follow the customer's directions as communicated to it by the transmitting bank.\textsuperscript{45} Third, in the absence of a contrary contractual provision,\textsuperscript{46} and depending on the jurisdiction, the transmitting bank may be liable for the negligence of the receiving bank.\textsuperscript{47} If a court holds the transmitting bank liable to the customer, it is entitled to indemnification by the receiving bank.\textsuperscript{48}

The amount of recovery for loss due to delay or failure to perform the fund transfer depends upon whether the customer elects to rescind the contract or to sue for damages. Since the cable transfer is an executory contract, the customer can elect to rescind the contract after unreasonable delay in its performance.\textsuperscript{49} If the court allows rescission, the customer can

\textsuperscript{42} This is the so-called "Massachusetts Rule." See Sneed & Morrison, Bank Collections—A Comparative Study, 29 Tex. L. Rev. 713, 727-28 (1951).

\textsuperscript{43} Under the "New York Rule," the receiving bank is an agent of the transmitting bank and a subagent of the customer. Id. at 728. The receiving bank is a subagent in the sense that the transmitting bank, not the customer, selects the bank to which the transfer is made. When the customer specifies which bank should receive the transfer, the receiving bank is an agent of the customer and the transmitting bank is not liable for its actions.

\textsuperscript{44} See Shrewsbury v. Dupont Nat'l Bank, 10 F.2d 632, 634 (D.C. Cir. 1925).

\textsuperscript{45} Id.; see also 6 A. Michie, supra note 34, at ch. 12, § 9.

\textsuperscript{46} Banks may disclaim liability for the acts of correspondents, carriers, and other necessary subagents. The courts will enforce these provisions unless the transmitting bank selects an unsuitable subagent. See Sommer v. Taylor, 190 N.Y.S. 153, 154 (N.Y. Mun. Ct. 1920). Corporate customers transferring large sums of money, however, do not agree to such disclaimers. Thus financial institutions involved in SWIFT transactions often accept liability to their customers for losses due to late payments, regardless of fault. Chemical Bank, for example, reimburses its corporate customers for interest losses resulting from delay in effecting a payment. Telephone interview with W. Robert Moore, Vice Pres., Chemical Bank, and U.S. Director of SWIFT (Jan. 16, 1980).

\textsuperscript{47} The transmitting bank's liability here would rest on the general agency principle that an agent is liable to its principal for the negligence of its subagent. See Restatement (Second) of Agency § 406 (1958). Michie points out, however, that under the majority Massachusetts Rule, see note 42 supra, the transmitting bank would not be liable for the negligence of the receiving bank since no agency relationship exists between them. 6 A. Michie, supra note 34, ch. 12, § 9. In New York, the center of much international banking activity, however, the common law rule appears to remain otherwise. See note 43 supra. There, the transmitting bank may be liable for the negligence of the receiving bank unless the customer selected the receiving bank. See, e.g., Myers v. Brown, 142 App. Div. 658, 127 N.Y.S. 374 (1st Dept. 1911), aff'd mem., 206 N.Y. 718, 100 N.E. 1130 (1912). Traditional banking practice, whereby transmitting banks normally reimburse their corporate customers for interest losses resulting from delay regardless of fault, minimizes the practical importance of the issue. See note 46 supra.

\textsuperscript{48} See Restatement (Second) of Agency § 428, Comment f (1958).

\textsuperscript{49} See Richard v. Credit Suisse, 242 N.Y. 346, 350-58, 152 N.E. 110, 111-14 (1926). The courts distinguish between a cable transfer and a bank draft or cashier's check. They describe an agreement to create a credit by cable as an executory contract and not an executed sale or
recover the amount that he paid under the transfer agreement plus interest.\textsuperscript{50} If the customer accepts the delayed performance and elects to sue for damages, however, he can generally recover the value of the foreign currency credit at the time of the breach plus interest.\textsuperscript{51}

The final issue of considerable importance in foreign remittance and credit transfers is the determination of the time of payment. Identifying the precise time of payment determines how long, if at all, a financial institution has delayed performance of the credit transfer.\textsuperscript{52} Despite the importance of this issue, courts experience much difficulty in determining the precise time of payment.\textsuperscript{53} Courts variously define the time of payment as the time when the receiving bank receives the credit message,\textsuperscript{54} the time when the receiving bank decides to debit the one account and credit the exchange. \textit{See} Gravenhorst \textit{v.} Zimmerman, 236 N.Y. 22, 27-34, 139 N.E. 766, 768-70 (1923). The courts characterize a bank draft, on the other hand, as an executed transaction on the grounds that the customer receives a negotiable instrument that he must send to the foreign beneficiary. In these cases, the courts disallow rescission as a remedy and the customer must rely on damages for breach. \textit{See} Kerr S.S. \textit{Co. v.} Chartered Bank, 292 N.Y. 253, 260-63, 54 N.E. 2d 813, 816-17 (1944).


\textsuperscript{51} Since the customer recovers only the value of the foreign currency at the date of the breach, he bears any loss caused by the depreciation of the foreign currency relative to his own subsequent to the contractual time of performance. Courts limit recovery to this amount when the funds involved were transferred for any purpose other than for resale in the foreign country on the ground that foreign currency cannot depreciate relative to itself. Thus a customer who contracts for the transfer of a specific sum to a foreign country for the purpose of paying a debt in that country can recover only that sum, regardless of its value in the customer’s native currency. \textit{See} Richard \textit{v. American Union Bank}, 241 N.Y. 163, 149 N.E. 338 (1925). If the customer can establish that the transferred funds were to be used for resale as a commodity in the foreign country, however, he may recover damages for the subsequent depreciation of the foreign currency relative to his own. \textit{See} Richard \textit{v. American Union Bank}, 253 N.Y. 166, 173-75, 170 N.E. 532, 535 (1930).

\textsuperscript{52} Time of payment is also important in determining whether funds have reached their destination by a time specified in a contract. \textit{See}, \textit{e.g.}, Tenax Steamship Co. \textit{v.} The Brimnes, [1973] 1 All E.R. 769 (Q.B.), \textit{aff'd}, [1974] 3 All E.R. 89 (C.A.) (delay in bank’s crediting transferred funds to shipowner’s account after transfer message received by bank allowed shipowner to withdraw ship from charter for nonpayment). Determining the time of payment is also important when a financial institution transfers funds to a bank that fails. \textit{See}, \textit{e.g.}, Delbrueck \& Co. \textit{v.} Manufacturers Hanover Trust Co., 609 F.2d 1047 (2d Cir. 1979).

\textsuperscript{53} \textit{See} Crawford, \textit{supra} note 39, at 135-43.

\textsuperscript{54} In \textit{Delbrueck}, a German banking partnership sued a New York bank for damages arising out of the latter’s transfer of the former’s funds to a third bank that failed immediately prior to the time of transfer. The German bank alleged that the New York bank was negligent in transferring the funds when it should have known of the third bank’s failure, and in failing to reclaim the funds after the transfer. The district court denied recovery on the ground that the New York bank exercised due care and the German bank was contributorily negligent. Delbrueck \& Co. \textit{v.} Manufacturers Hanover Trust Co., 464 F. Supp. 989 (S.D.N.Y. 1979). The second circuit affirmed the district court’s decision, but on the ground that the payment was final upon the release of the transfer message to the receiving bank. 609 F.2d at 1050-52.
other, the time when the receiving bank actually completes the bookkeeping entries to credit the payee's account, and the time when the payee receives notice of the credit.

 Attempts to apply the above principles to SWIFT transactions create some complications. First, the addition of the switching centers to the two financial institutions involved in the transfer complicates choice of forum and choice of law issues. In some situations, the law of the place where the switching center is located may provide a third possibility for the choice of law. Second, the switching center adds another level of complexity to the problem of characterizing the nature of the legal relationships created. A court might characterize the switching center as an agent of either the customer or the transmitting bank. Thus, depending on the jurisdiction and the agreement between the transmitting bank and customer, the transmitting bank may be liable for the switching center's negligence or failure to perform properly. Third, the new technology of the SWIFT system complicates the standard of care and liability issues. To determine negligence, courts must delve into the technical aspects of the message switching networks. When an organization fails to define clearly the operational responsibilities of the participants, as SWIFT failed to do prior to the new rules, it will be difficult for the courts to determine objectively which party failed to exercise ordinary care. Finally, in light of the uncertainty surrounding the determination of the precise time of payment, it is safe to say that the courts have failed to establish any clear principles to apply to a SWIFT transaction.

 Thus, general legal principles are inadequate to deal with the new technology of SWIFT transactions. The best way to deal with the rights and

56. See id.
58. See text accompanying notes 36-38 supra.
60. That is, whether the court follows the New York Rule or the Massachusetts Rule. See notes 42-43 supra.
61. The agreement between the transmitting bank and the customer may contain a disclaimer. See note 46 supra.
63. See text accompanying notes 53-57 supra.
64. In addition to general legal principles, some provisions of the Uniform Commercial Code could be applied to SWIFT transactions. Although the Code does not explicitly contemplate electronic transactions, some provisions of Articles 3 and 4 might have a literal application to SWIFT messages. For example, a SWIFT message might be an “item” under U.C.C. § 4-104(1)(g) (“any instrument [calling] for the payment of money [to a third person]”). See Clarke, An Item is an Item is an Item: Article 4 of the U.C.C. and the Electronic Age, 25 BUS. LAW. 109 (1969); GEORGIA INSTITUTE OF TECHNOLOGY, ATLANTA PAYMENTS PROJECT, 6 RE-
obligations of the SWIFT participants is to draft a comprehensive agreement defining their rights, responsibilities, and liabilities.

2. Dispute Settlement Prior to the New SWIFT Rules

Prior to the new rules, the responsibilities and liabilities of the financial institutions and the switching center were unclear. Previous guidelines in the SWIFT User Handbook provided that SWIFT was responsible for loss of interest only "if it was related to a nonrecoverable loss of funds representing the principal amount of a customer or bank transfer." Section 7 failed to define the circumstances under which the transmitting bank, the SWIFT switching center, or the receiving bank would be liable for interest losses. To avoid the high costs and delays of litigation, member financial institutions often settled disputes over interest by negotiation and compromise. The transmitting bank usually had to bear the risk of loss. This result was unfair when the receiving bank's failure to follow the guidelines or the switching center's failure to perform properly caused the delay. According to the directors of SWIFT, "interest losses have been sustained by members as a result of Senders or Receivers failing to adhere to the rules and co-operative intent of the Society. Further, S.W.I.F.T. has on occasion 'failed to perform', causing interest losses also." In response, the directors promulgated a set of rules to allocate liability for interest losses.

SEARCH ON IMPROVEMENTS OF THE PAYMENTS MECHANISM 17-18 (1972) [hereinafter cited as ATLANTA PAYMENTS PROJECT]. Under U.C.C. § 4-103(5), therefore, a receiving bank may be liable to a transmitting bank "for failure to exercise ordinary care in handling an item." In addition, U.C.C. § 4-103(1) would permit SWIFT participants to vary by agreement the terms of Article 4 to the extent that they did not disclaim liability for their own failures to exercise due care or limit the measure of damages. Subsection (2) implies that the SWIFT rules would have the effect of such an agreement ("Federal Reserve regulations and operating letters, clearing house rules, and the like, have the effect of agreements under subsection (1)"). U.C.C. § 4-103(2) (emphasis added).

This brief analysis indicates that certain provisions of Article 4 could have application to SWIFT message transfers. The Code, however, contemplates paper-based transactions rather than electronic transfers. The drafters designed the provisions for a debit transfer system rather than a credit transfer system. Since there are great practical and theoretical difficulties in determining which Code provisions apply to SWIFT transactions, the best way to deal with the rights and obligations of the SWIFT participants is to draft a comprehensive agreement defining their rights, responsibilities and liabilities. See ATLANTA PAYMENTS PROJECT, supra, at 63.

65. The SWIFT User Handbook is available only to members and does not circulate.
68. Id.
II
NEW SWIFT RULES

A. ALLOCATION OF RESPONSIBILITY AND LIABILITY

The new SWIFT rules address four issues that affect the liability of financial institutions for interest losses caused by delay in SWIFT transactions: choice of forum and applicable law, standard of care and liability, amount of recovery, and time of payment.

First, section 7 of the User Handbook reduces the choice of forum and applicable law problems for claims against SWIFT. The rules provide that if both the transmitting bank and receiving bank claim to be without fault, they must jointly present a claim to SWIFT on behalf of the transmitting bank. The interest loss, however, must exceed 100,000 Belgian Francs (BF) before SWIFT will hear the claim. In addition, members may not accumulate losses to meet the 100,000 BF requirement; each claim must deal with a separate event. After the claimant satisfies these conditions, SWIFT will investigate the claim and either reject or accept it. If SWIFT rejects the claim, however, it will charge the claimant 30,000 BF.

Second, section 7 carefully defines which party will be liable for interest losses under various circumstances that result in delays or losses of messages. In effect, the network has codified the standard of care that a financial institution must meet to escape liability.

The transmitting bank is responsible in five circumstances: (a) if SWIFT fails to acknowledge the transmission of a message; (b) if SWIFT acknowledges it, but the message appears on the report of undelivered messages; (c) if the transmitting bank enters an urgent message, but receives no delivery notification from SWIFT; (d) if it enters a message in an inappropriate format; or (e) if it fails to react promptly to notification by SWIFT that a bank, regional processor, or operating center is not functioning.

The receiving bank is responsible in four circumstances: (a) if it fails to carry out the payment date instructions in the message; (b) if it fails to react promptly to system messages; (c) if it fails to reconcile adequately incoming messages according to sequence numbers; or (d) if it fails to
follow SWIFT's terminal connection policy.\textsuperscript{77}

SWIFT is responsible in three circumstances: (a) if it acknowledges a message to the sender, but fails to put the message on the undelivered message report and fails to deliver the message; (b) if it or its personnel perform improperly; or (c) if it fails to notify members promptly of failures of banks, operating centers, or regional processors.\textsuperscript{78}

Third, the rules limit the amount of SWIFT's liability for interest losses caused by delay. If SWIFT is liable, it will reimburse claimants only for interest losses in excess of 100,000 BF per event.\textsuperscript{79} At the end of the budget year, SWIFT will reimburse claimants by setting up credits against future invoices from SWIFT.\textsuperscript{80} To cover the claims, SWIFT must establish an annual "interest loss contingency item" of 20,000,000 BF.\textsuperscript{81} This amount represents the ceiling on SWIFT's liability. If accepted claims exceed 20,000,000 BF per year, SWIFT will reimburse claimants on a pro-rata basis in proportion to the value of their accepted claims.\textsuperscript{82} The rules do not address the amount of a member bank's liability, implying that the member is liable for the full amount of interest losses for which it is responsible.

Finally, although the SWIFT rules do not define the precise time of payment,\textsuperscript{83} they define and clarify "time of receipt,"\textsuperscript{84} "value date,"\textsuperscript{85} "pay date,"\textsuperscript{86} and "cutoff time."\textsuperscript{87}

\textbf{B. Effectiveness of SWIFT Rules}

The new rules are a great improvement over previous guidelines and will serve as an example for other interbank fund transfer networks. The other major banking networks have not defined the responsibilities in their systems nearly as well.\textsuperscript{88}

\textsuperscript{77} \textit{Id.} § 5.
\textsuperscript{78} \textit{Id.} § 6.
\textsuperscript{79} \textit{Id.} § 7(b) and Comments to § 7(b), at 4.
\textsuperscript{80} \textit{Id.}
\textsuperscript{81} \textit{Id.}
\textsuperscript{82} \textit{Id.,} Comments to § 7(b), at 4.
\textsuperscript{83} \textit{See} text accompanying notes 52-57 \textit{supra.}
\textsuperscript{84} "The time of receipt of a message at the [receiving bank] shall be the output time." \textit{Board Paper 185, supra} note 29, § 1.
\textsuperscript{85} "The value date defines the date when the amount of the transfer is at the disposal of the Receiving Bank." \textit{Id.} § 2(a). The value date is important only to the banks involved in the transfer.
\textsuperscript{86} The pay date "defines the date on which the Receiving [Bank] or a third Bank is requested to credit or pay the beneficiary customer (private person or any other non-banking institution)." \textit{Id.} § 2(b).
\textsuperscript{87} "Cutoff time is the latest time of day . . . for Receiving Banks to apply same day value to effect funds transfers in domestic currency in favour of third banks." \textit{Id.} § 3.
\textsuperscript{88} In the CHIPS systems, the 12 New York Clearing House banks shoulder much of the risk. \textit{SWIFT Codifies Liabilities}, American Banker, June 18, 1979, at 22, col. 1. Section 14 of
First, the rules minimize choice of forum and choice of law problems for claims against SWIFT. Rather than having to choose a competent forum in which to sue and then argue which country's law applies, financial institutions can present their claims to SWIFT. SWIFT will then determine the merits of the claim pursuant to the new rules. This result is desirable because it allows financial institutions to settle disputes quickly, out of court, and before a body capable of resolving technical issues. Allowing SWIFT to determine its own liability, however, seems to create an inherent conflict of interest. Indeed, in other contexts, this method of dispute resolution would violate the principle of impartiality, thus reducing party satisfaction. The unique legal arrangement of the SWIFT network, however, mitigates any conflict of interest that might be present. SWIFT is liable only to the extent of the amount in the interest loss contingency item fund, which comprises payments by member banks. Moreover, the network created this fund exclusively to cover interest losses caused by SWIFT failures. Thus SWIFT has no incentive to reject any valid claim.

With respect to claims against member banks, however, the rules provide no body to hear and no forum in which to hear claims. In addition, there are no procedures to enforce the liability rules against a member. The rules assume that liability for losses will be self-evident under the new guidelines. This suggests that member banks may still settle their disputes through negotiation and compromise. Thus situations may still arise in which members fail to resolve a dispute between themselves. One possible solution would be to adopt procedures permitting SWIFT to function as an impartial arbiter upon application of one of the parties. Under this arrangement SWIFT would supply the authoritative enforcement mechanism that is now absent. To eliminate small and frivolous claims, the network

the CHIPS rules provides that "[t]he Clearing House shall not be responsible for any loss in the use of funds resulting from a system error. Any such loss shall be settled directly between the participants involved." Rules Governing the Computerized Clearinghouse Interbank Payments System, § 14 (1979).

In the Fed Wire system, Federal Reserve Banks must follow operating procedures and written agreements with member banks. 12 C.F.R. § 210.64 (1980) sets out the limitations on the liability of a Federal Reserve Bank. Section 210.64(a) provides that a Federal Reserve Bank is liable only to its immediate transferor and only for its own or another Federal Reserve Bank's lack of good faith or failure to exercise ordinary care.


89. Board Paper 185, supra note 29, § 7(b). Section 7 deals only with claims against SWIFT.

90. Id.

91. "Liability should be clear in the event of Sender's or Receiver's failure to adhere to rules." Id. § 7.
could establish prerequisites to making a claim similar to those now in effect for claims against SWIFT. For example, the network might allow SWIFT to resolve only those claims that exceed a specified amount and charge the claimant a penalty fee if SWIFT rejects its claim. Thus, one alternative to the present arrangement would be to extend SWIFT’s jurisdiction over claims to include claims by one member against another.

Second, the new rules clearly define the standards of care that each participant must meet, enabling the network to impose liability on the party that failed to perform or to follow the rules. This is especially true in the case of SWIFT’s liability. The previous guidelines imposed liability on SWIFT for interest loss only “if it was related to a nonrecoverable loss of funds representing the principal amount of a customer or bank transfer.” That provision failed to define the circumstances in which SWIFT would be liable and severely limited recovery. Similarly, the old guidelines completely ignored the operating responsibilities of the member institutions. The new rules provide objective measures for determining fault. As section 7 of Board Paper 185 states, “Liability should be clear in the event of Sender’s or Receiver’s failure to adhere to rules.” In the event that a dispute does reach a court, the rules provide an objective measure with which to determine negligence and allocate liability.

Third, the establishment of an “interest loss contingency item” fairly distributes the losses that SWIFT causes. Since each member owns part of the share capital of SWIFT, each shares the costs of its operation. Claims for interest loss that SWIFT must pay because of its failure to perform properly are merely one component of these costs. Since all members receive the benefit of SWIFT, requiring them to share the costs of SWIFT’s failures seems fair. In addition, limiting claims to losses in excess of 100,000 BF and charging unsuccessful claimants a penalty fee of 30,000 BF will eliminate small claims and minimize frivolous claims.

Finally, clarification of such terms as “time of receipt,” “value date,” “pay date,” and “cutoff time” reduces the problems that arise

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92. SWIFT will only reimburse claims in excess of 100,000 BF and, if SWIFT rejects a claim, it will charge the unsuccessful claimant 30,000 BF. Id. § 7(b).
95. Id. § 7(b).
96. Id.
97. Id.
98. See note 84 supra.
99. See note 85 supra.
100. See note 86 supra.
101. See note 87 supra.
in international transfers when time of payment is important but incapable of precise determination. For example, a corporation might contract to make a payment to a specified beneficiary by a certain time. The new definitions provide an objective measure for determining whether the payment message arrives on time. This determination is essential for the effective resolution of disputes over interest losses. In addition to identifying the relevant points in time, the use of these definitions will indicate whether a receiving bank had a sufficient amount of time to complete the payment. Thus the clarifications are useful in allocating responsibility for late payments.

III

UNRESOLVED ISSUES

Although the new SWIFT rules are an important step in the development of international fund transfers, they ignore three potentially important risks. As international payments increase in value and volume, the problems created by fluctuating exchange rates, force majeure, and fraud will become more serious.

The risk that the value of the currency of the beneficiary's nation will decline relative to that of the customer's between the time of initiating an international fund transfer and the actual time of the transfer normally falls on the customer. When the customer must bear the loss, there will be no dispute between the financial institutions involved in the transfer. If the transfer is not made at the stipulated time, however, the financial institutions must bear the loss. Rules have developed under existing case law to allocate the liability on the basis of fault for the delay, but these principles are inadequate to deal with SWIFT technology. Although the new SWIFT rules do not explicitly allocate liability for this type of loss, they could be easily applied to this situation. The same operating responsibili-

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102. These definitions are also important in cases of bank failures. For example, if a receiving bank fails, the definition of a value date (the date when the receiving bank has the use of transferred funds) is useful to determine whether the funds were still the property of the transmitting bank at the time of the failure or are subject to the claims of the receiving bank's creditors. See Crawford, supra note 39, at 144, for the suggestion that all credit transfers should indicate a value date and hour.


104. Financial institutions bear the depreciation loss only if the funds are transferred for the purpose of resale as a commodity in the foreign country. See id.

105. See notes 44-48 supra and accompanying text.

106. See text accompanying notes 58-64 supra.

107. Board Paper 185, supra note 29, deals with responsibility for interest losses only.
ties developed to allocate liability for interest loss due to delay could be used to allocate liability for depreciation loss due to delay.

The new SWIFT rules also ignore the potential effects of unforeseen contingencies—such as war, civil strife, or sabotage—on international fund transfers. These problems might become more serious as SWIFT expands operations into Asia and South America and each switching center approaches its load capacity. The new rules indicate that SWIFT is liable for any interest loss caused by a failure of its switching system or personnel. SWIFT should protect itself by adopting a force majeure provision absolving it of liability for any loss attributable to a system failure caused by external conditions beyond its control.

A more important omission in the new SWIFT rules are provisions on the risk of fraud. Computer crime has multiplied in the last decade. Despite the security measures adopted by SWIFT, the network remains a target for computer fraud. To succeed, the perpetrators must first gain access to the switching system either by breaking into the communications lines or colluding with an employee of a member bank or SWIFT itself. They would then have to obtain secret bank code numbers and output sequence numbers. The final step would be the transmission of a payment message through the SWIFT system containing instructions to pay a dummy beneficiary. If the system operated properly, this message would have to be authenticated prior to transmission and sequentially identified by the transmitting and receiving banks. Thus the chance of success, in the absence of inside assistance, is small.

SWIFT should address the problem of fraud before a member institution incurs any loss. SWIFT presently relies on each member institution to obtain its own insurance.

108. SWIFT originally intended the three switching centers to be fully redundant so that if one had to shut down, the others could handle the message load. See New SWIFT Network, supra note 5, at 49. Each switching center can accommodate up to 225,000 messages per day, approximately the current volume of messages, and any two together can accommodate up to 375,000 transactions per day. SWIFT U.S. Center to Start Up in Feb., American Banker, Dec. 4, 1979, at 3, col. 3. If SWIFT fails to continue expanding the switching centers as message volume increases, the unforeseen closing of one switch could cripple the network temporarily.


111. See note 30 supra.

tional Automated Clearing House Association, would be to encourage its members to maintain a specified level of insurance coverage. In addition, SWIFT could adapt the new rules on liability for interest losses to impose liability on a member institution whose failure to follow proper operating procedures causes the loss. Thus, if the receiving bank's failure to sequentially identify each message materially contributes to the success of a fraudulent scheme, it should be held liable for any loss. Finally, the network could create a "fraud contingency item" fund to cover losses in excess of insurance coverage resulting from the switching center's failure to perform properly.

CONCLUSION

The new SWIFT rules are a major step forward in the allocation of liability for interest losses. They provide a competent body to settle claims against SWIFT, clearly and objectively define the standard of care that each bank must meet, distribute system-caused losses fairly, and largely eliminate problems with respect to the time of payment. Despite these improvements, however, the rules fail to provide a forum and a mechanism for adjudicating claims between member banks. Similarly, the rules ignore some issues of increasing importance. As the value and volume of SWIFT payment messages increase, the problems posed by fluctuating exchange rates, unforeseeable contingencies, and computer fraud assume growing importance. To prevent disputes in the future, the SWIFT network must address these issues now.

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115. The CHIPS rules provide that "[a]ny loss incurred due to a fraudulent transfer originating at a participant shall be borne by such participant." Rules Governing the Computerized Clearing House Interbank Payments System, § 15(a) (1979).

116. The CHIPS rules hold the clearing houses liable for losses resulting from fraudulent transfers originating at the clearing houses, to the extent of their insurance coverage ($25 million). If the loss exceeds the insurance ceiling, the participants must bear the excess on a prorata basis according to the dollar volume of messages that they sent in the preceding month. Id. § 15(b).

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