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When it comes to banks, Russia's invasion of Ukraine raises the important question of what is truly relevant when assessing value for investors. Is it just the preservation of prudential and financial health in the face of growing financial risk so that investors do not face permanent losses? Or is it more than that, going beyond what those who assess bank risk usually focus on?

So far, the market has reacted with anticipated fear to the Ukraine war. The Euro STOXX Banks Index is down more than one-third since its high a month ago; the share prices of banks most exposed to Russia have fallen even more acutely. The trend will get worse before it gets better.

Investors' short-term violent reactions, last witnessed two years ago at the start of the pandemic, are driven by apprehension about loan losses and earnings collapse stemming from the Ukraine war. That will not be the case, however, as most analysts have pointed out based on what the banks with exposures in the region have disclosed since Russia invaded.

For me, far more is at stake. What banks do and how they act should not be determined by the short-term reactions of traders and investors. Going beyond shareholders and bond holders, the banks need to relate to a broader range of stakeholders, and even more importantly to their own corporate-citizen identity in the world in which they operate.

Even if it is risk-averse and financially profitable under current circumstances (though it will become less so as the rouble melts down and the economy craters), European banks may want to put an end to their presence in Russia altogether. In fact, I believe they will have to, and sooner rather than later, for the following reasons:

1 The economic and financial situation of Russia is taking a turn for the worse, including the ruble meltdown. This trend will not reverse any time soon, unless Russia's political dynamics change dramatically (less likely in the short term)

2 The business, political and information constraints within Russia will become increasingly more restrictive and less compatible with Western institutions' modus operandi

3 In Europe and elsewhere, the public opprobrium of being associated, even if indirectly, with the Russian regime and its war in Ukraine will take a toll on the implicated banks' overall image if they stay put.

The reaction of banks to the Russian invasion can also be viewed from an ESG angle. Specifically, it is the S which is in question: a Western bank anchored in a free-market democracy is not expected to carry on blithely operating in a country that has illegally turned into a violent international aggressor. Fighting for climate change should remain a priority for financial institutions, but so should be aiming for the social red line of human rights and human life.

No asset-quality crisis from exposures to Russia and Ukraine…

Russia's invasion of Ukraine will not lead to an asset-quality crisis for European banks with a material presence in the two countries. Since Russia's annexation of Crimea in 2014, international banks have substantially reduced their activities in the region – especially in Ukraine – so this new development does not represent a major blow for their balance sheets.

To reassure the market, European banking groups with a material footprint in Russia and Ukraine's banking landscapes have provided details on their exposures to the region. The numbers show that the exposures, even if they turn into total write-offs, would not materially harm the parents' prudential and financial indicators.

There are several large European banks with a more significant footprint in Russia's retail and commercial banking landscape: Société Générale, UniCredit, RBI, and OTP. A few others, like ING and Intesa, focus mostly on business and wholesale banking in Russia.

The banks in question rightly point to capital buffers more than sufficient to absorb Russia-related losses, to substantial liquidity cushions, and to positive inflows from local activities which would mitigate any risks. Referring to what they euphemistically call "the situation in Ukraine and Russia", the banks also duly clarify that they are committed to complying with all applicable laws and regulations and to enforcing international sanctions.

Based on such reassuring inputs, analysts and rating agencies have kept a relatively benign view of the impact of the Russian invasion on European banks. I expect that at a forthcoming European banks international conference[1] the Ukraine crisis will be in focus, but mostly regarding the financial impact of banks' exposure and activities in the region.

European supervisors have not yet made any specific comments or taken any specific steps in relation to the war in Ukraine, other than the ECB and FINMA flagging the failures of Sberbank's Austrian and Swiss subsidiaries. Given the gravity of the situation arising from Russia's invasion, some informal supervisory guidance could be useful on what course of action European banks should take: in Russia and Belarus (under Western sanctions) on one hand; Ukraine (under Russian attack) on the other.

… But a presence in Russia may be a problem

Among banks with a material presence in Russia, only Intesa has so far announced that it is reviewing the strategy of its Russian activities. Other European banks in the country remain committed for the time being, in the absence of any statement to the contrary. However, this may not last if the current trajectory of events continues and amplifies, as it is likely to do.

More and more businesses are exiting Russia – from oil, food and beverage, consumer goods, electronics, to insurance, auditing, cards and payments, airlines, media and entertainment. This rush to the exit will probably continue apace.

[1] Morgan Stanley's European Financials Conference, London, 15-17 March 2022.

The catalysts are highly punitive economic and financial sanctions instituted by Western nations, which substantially reduce the attractiveness of Russia as a country to do business in, among other things by clobbering the ruble.

Equally important is the power of the global public opinion exerted through social media and massive demonstrations in Europe and elsewhere.

Even if Western companies adopt the view that business should be separate from politics (although invading a foreign country with deadly force stretches the definition of politics to breaking point), most customers, counterparties and investors think otherwise. At a time when brand quality is gaining in importance for attracting and keeping customers, this is no small thing. Millennials and Generation Z seem to be particularly sensitive to banks' social brand image.

European banks present in Russia may feel that they are between a rock and a hard place, but that is not so. The claim that the Russian balance sheet consists of domestic loans funded with domestic deposits or other sources is true. But it only informs the fact that there is very limited cross-border risk coming from Russian subsidiaries.

It does not address the unsavory possibility that the business loans extended by those subsidiaries may, even indirectly, contribute to Russia's war and disinformation effort. It is not that those Russian subsidiaries would knowingly finance the country's defence industry. But, as the Kremlin adjusts itself to support a potentially longer-term military occupation of Ukraine, more private businesses may be pulled willy-nilly into this effort, and not necessarily with the knowledge of the financing bank.

Similarly, a portion of banks' domestic liquidity consist of Russian public debt holdings, directly contributing to the government's financial needs which would plausibly include the "special military operations" business.

Another aspect which could give European banks present in Russia pause is that their subsidiaries are excluded from the time being from the SWIFT interdiction imposed on seven Russian banks. In pure competitive terms, these subsidiaries could see more business migrating their way from interdicted banks – both in deposits and in loans.

This will be true especially if or when Sberbank is also excluded from SWIFT. The question is whether this would be the right approach for their Western parent companies, when being mindful of what the true rationale is for imposing financial sanctions on the Russian banking system – including the SWIFT exclusion.

For a Western bank, the cleanest and potentially least expensive avenue to exit Russia would be to simply write off its investment and walk away. Precisely because the bulk of the Russian subsidiaries' balance sheets consist of rouble-denominated assets funded with rouble-denominated deposits and other resources – with little cross-border or cross-currency exposures.

Given the relatively small size of Russian balance sheets within the parent groups, consolidated capital positions would not be threatened, and losses would remain manageable. In fact, the rouble meltdown makes the decision to call it a day easier, as the magnitude of the Russian business in the overall group will keep shrinking further. Another factor facilitating an exit is the near-default status of Russia's foreign-currency debt.

The Russian banks they would leave behind could be plausibly merged into other domestic banks, or nationalised. But that would no longer be European banks' concern.

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Scope SE & Co. KGaA

Lennéstraße 5
10785 Berlin
info@scopegroup.com

Scope Ratings GmbH
Lennéstraße 5
D-10785 Berlin
info@scoperatings.com

Scope Ratings UK Limited
52 Grosvenor Gardens
London SW1W 0AU
info@scoperatings.com

Scope ESG Analysis GmbH
Lennéstraße 5
D-10785 Berlin
esg@scopegroup.eu

Scope Analysis GmbH
Lennéstraße 5
D-10785 Berlin
info@scopeanalysis.com

Scope Investor Services GmbH
Lennéstraße 5
D-10785 Berlin
info@scopeinvestors.com

Scope Hamburg GmbH
Stadthausbrücke 5
D-20355 Hamburg
info@scopehamburg.com

www.scopegroup.com
www.scoperatings.com
www.scopeanalysis.com
www.scopeinvestors.com
www.scopehamburg.com

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