EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Andrea ENRIA

Chair of the Supervisory Board

COURTESY TRANSLATION

Mr Marco Zanni
Mr Valentino Grant
Mr Antonio Maria Rinaldi
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 6 April 2022

Re: Your letter (QZ-007/2022)

Honourable Members of the European Parliament, dear Mr Zanni, Mr Grant, Mr Rinaldi,

Thank you for your letter on the potential impacts on the European financial system of the sanctions imposed on the Russian Federation, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 2 March 2022.

The multifaceted and evolving nature of the sanctions framework adopted in response to the Russian invasion of Ukraine makes it challenging to provide a holistic assessment of its impact on the European banking system. Adding to the impact of the sanctions on the Russian Federation, the risks faced by European banks may also be affected by countermeasures adopted by the Russian Government towards western European countries. Assessing the sanctions' impact is rendered more complex by possible second-round effects, including dislocations on energy and commodity markets leading to broader repricing on financial markets, asset quality deterioration across loan portfolios and potential cyberattacks.

When looking at the direct effects of the Russian invasion on euro area banks, the direct financial exposures to Russia currently suggest limited first-order effects on euro area financial stability. Direct exposures to Russia are contained at the aggregate level, even though they are concentrated in a few banks. The available evidence indicates that exposures to entities affected by EU sanctions represent a minor share of direct exposures to Russia.

Since the escalation of the war, ECB Banking Supervision has initiated a regular and open dialogue with the banks to discuss the affected risk exposures and possible repercussions of sanctions on the European

banking system, including SWIFT-related sanctions. Banks are working to enhance their governance frameworks when operationalising the implementation of sanctions in their systems and arrangements. At the same time, they are assessing the impact of sanctions on their risk profiles as well as updating their scenario analyses to understand related potential losses, and some of them have already disclosed the potential impacts.

As a consequence of the sanctions, and the retaliatory measures implemented by the Russian Federation, significant institutions that are established in Russia may decide to exit the Russian market. The impact of such a choice would depend on the exit scenario. According to our analysis, even in an extreme scenario entailing an exit from Russian subsidiaries with full loss of the equity investment and a full write-down of cross-border exposures, the average impact would remain manageable at between 70 and 95 basis points of CET1 capital. None of the nine significant institutions with an establishment in Russia would suffer a CET1 capital depletion greater than 200 basis points, and all would continue to comply with supervisory requirements and buffers.

Sanctions can also trigger reputational impacts for banks in the euro area with strong links to Russia, as demonstrated by the declaration, on 28 February 2022, of Sberbank Europe AG and its subsidiaries in Croatia and Slovenia as failing or likely to fail, following a deterioration of their liquidity situation. More recently, RCB Bank n Cyprus decided to sell most of its assets to a competitor and proceed with a voluntary wind-down of its business.

Against this background, ECB Banking Supervision will continue to closely monitor banks' responsiveness to all relevant risks, the sanction environment and its consequences for balance sheets, internal control arrangements and reputation.

Yours sincerely,

[signed]

Andrea Enria