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Ukrainian Crisis: European Banks Are Resilient

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The Russian invasion of Ukraine should not have a material, direct adverse effect on European banks. Only a few European banks have substantive exposures to the Russia/Ukraine/Belarus space, and those exposures do not impact banks' capacity to service their AT1 capital securities.

Those few banks with material exposures have adequate levels of capital, reserves and earnings to absorb potential losses – even under a 'walk away' scenario. These exposures can come in several forms: equity investments in subsidiary banks domiciled in affected nations; loans from the parent bank to such subsidiaries; direct loans from the parent to borrowers in those nations; investments in securities issued by firms in affected nations or the sovereign; exposures to counterparties in affected nations; or loans to entities that are collateralized by assets in the affected nations, *inter alia*. For many months during the peak of the COVID pandemic, European banks were limited on paying common stock dividends or repurchasing stock. This had the positive effect of boosting already sound capital levels, providing an extra layer of resilience.

In a speech on 15 March this year, Andrea Enria, chairman of the European Central Bank's Supervisory Board, noted that European banks had 'strong capital' and 'positive lending dynamics' at the end of 2021. Mr. Enria noted that although the 'invasion of Ukraine reversed a steady improvement in investors' stance on EU banks,' that 'direct exposures to Russia are manageable overall' and that the 'impact from Russian links [is] so far contained.' He also said that 'even extreme "walk away" scenarios from subsidiaries in Russia owned by significant institutions seem manageable given the currently solid group capital position.' And finally, Mr. Enria stated that banks can pay common stock dividends and buyback shares if they are 'consistent with sound capital planning and capital targets.' Spectrum views these statements to be supportive of AT1 payments.

Nevertheless, exposures to these war-affected nations are challenging, and many such exposures will likely result in losses to some extent. In addition, there are the lost earnings to consider for firms exiting previously profitable activities in these nations due to sanctions or management judgment – a clear 'Social' and 'Governance' matter. Furthermore, the Russian invasion of Ukraine is having widespread effects on the prices and availability of many commodities, including food, energy and various raw materials, as well as sending millions of refugees into eastern Europe and elsewhere. Plus, the inevitable political and social fallout – the full aspects of which are not yet clear – will likely have widespread and material effects on national economies, banks, and the businesses and people they serve. Some of these effects could be positive, such as stepped-up investment in domestic-based, especially green, energy. Others less so. Although these challenges are worrisome, they will likely emerge over time and probably softened by governmental help, as was true for COVID. **Spectrum believes that Europe's banks remain well positioned to meet these emerging challenges.**

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