Bank Pulse: Closures of European subsidiaries of Russian banks may lead to higher costs for European banks

Closures of European bank subsidiaries of Russian banks may result in payout events for European Deposit Guarantee Schemes. As these schemes are accrued by local banks, payout events are likely to lead to higher costs for banks in the country

VTB Bank (Europe) SE is domiciled in Frankfurt and subject to banking supervision by the ECB

Several indirect points of impact from the war for European banks

Russia's attack on Ukraine and the resulting economic sanctions have already impacted European banks in several ways, many of which are indirect. One potential impact is in the form of higher payments from banks to Deposit Guarantee Schemes in EU member states such as in Germany and Austria. The events come ahead of the expected update of the European Crisis Management and Deposit Insurance framework that was created to set rules for handling failing banks while protecting depositors across the Union.

Press sources indicate a possible closure of VTB Bank Europe

On 3 March, Reuters ran a story saying that the German regulators are preparing for a possible closure within days of VTB Bank (Europe) SE, the European arm of Russia's second-largest bank, VTB Bank PJSC, amid growing concerns about the impact of Western sanctions. Furthermore, Bloomberg ran a story on 7 March, indicating that German authorities are trying to find a solution that avoids an automatic triggering of payouts to clients, while still bracing for a potential wind-down of VTB Bank PJSC's European operations, citing people with knowledge of the matter. Bloomberg notes that the upfront hit to other banks in Germany could reach multi-billion dollar levels.

VTB Bank (Europe) SE is domiciled in Frankfurt and subject to banking supervision by the ECB and German BaFin with branch offices in Vienna and Frankfurt, together with onlinebank VTB Direktbank. VTB indicates to serve over 140 correspondent banks in Russia, especially in clearing euro transactions and processing cross-border payment orders using SWIFT or its own electronic banking system. In addition, VTB serves 160,000 private clients in Germany via Direktbank and 600 companies. According to Reuters VTB has attracted German retail clients and local governments in recent years, partly because it was one of a handful of banks that did not charge negative interest rates. According to its financial statements VTB Europe had €7.9bn in total assets as of 3Q21, with its businesses including payment transactions and lending to banks and customers such as trade finance. Customer lending amounted to €5.1bn. The business is financed particularly by customer deposits of €4.4bn and by bank deposits of €1.2bn. The bank's total capital was €1.1bn as of end-2020.

VTB Europe is a member of the German statutory deposit guarantee scheme (DGS), the Entschädigungseinrichtung deutscher Banken (EdB), and also of the voluntary top-up insurance scheme operated by the association of German banks, the Einlagensicherungsfonds des Bundesverbandes deutscher Banken. The EdB offers up to €100k coverage per depositor, while the Einlagensicherungsfonds extends coverage to a wider group of depositors, and up to 15% of a bank's capital. In the case of VTB Europe, this could imply up to €169m coverage per deposit based on own funds of €1,12bn. VTB could be assessed as not conducting critical operations in Germany (based on its small size), but it is considered a significant institution based on the cross-border nature of its business.

Deposit guarantee scheme payout would burden the whole local banking sector

In general, if it is considered that in the case of trouble there is no public interest to put a bank into resolution, the bank in question would be wound down via national frameworks. Winding down a bank and liquidating its assets may take quite some time. In the meantime, guaranteed depositors would be looking for payment. In the case of a German bank, if a deposit guarantee payout event were to be triggered then German deposit guarantee schemes that the bank is a party in, and all the banks paying into them, would be on the hook for losses. An alternative to this scenario could include finding another bank to take over part of the business and / or deposit base of the bank in trouble. This would decrease the burden on the deposit guarantee system and thus the overall banking sector, but finding a buyer with a good business fit may come with its own challenges.

German banks were burdened in only March last year, with the collapse of Greensill Bank AG. Greensill was reported by Bloomberg to have €3.5bn in deposits, €1.1bn of which covered by the mandatory deposit fund and €2bn by the voluntary scheme. In April 2021 Bloomberg indicated that banks, in addition to the existing contributions, would need to plug a hole of €1.1bn in the mandatory deposit guarantee fund created by Greensill payouts, spread across four years and equalling some €275m per year. In the aftermath of the Greensill payout, the Einlagensicherungsfonds implemented reforms to restrict coverage and the depositors in scope. Those reforms will however enter into force in 2023.

Worries follow the collapse of Sberbank Europe AG in Austria

The worries over the status of VTB follow the announcement from the Single Resolution Board (SRB) on 28 February stating that Sberbank Europe AG in Austria and its subsidiaries in Croatia and Slovenia were failing or likely to fail due to a rapid and significant deterioration of the banks' liquidity situation. These three banks were put under moratorium. The bank had €13.4bn in total assets of which €6.8bn in Austria, Croatia and Slovenia.

On 1 March the SRB announced that resolution schemes had been adopted for the Slovenian and Croatian subsidiaries and these subsidiaries were sold using the sale of business tool. No aid for the subsidiaries were granted. The Austrian parent was not considered to provide critical functions to the Austrian economy. The SRB indicated that resolution action for Sberbank Europe AG, the Austrian parent bank, was not needed and instead insolvency proceedings under Austrian law would be carried out. The official prohibition of continuation of business operations legally triggers the deposit guarantee payout event and the Austrian deposit guarantee scheme was required to pay eligible deposits of up to €100 000.

On 2 March BaFin noted that German depositors in the German branch were covered by the Austrian deposit guarantee scheme as well. The Compensation Scheme of German Private Banks (Entschädigungseinrichtung deutscher Banken GmbH – EdB) would be responsible for handling the pay-out of deposits totalling €913m to German customers on behalf of the Austrian DGS.

Higher deposit insurance costs ahead for Austrian, maybe also for German banks

Russia's war on Ukraine and the following economic sanctions have already impacted European banks in several ways. One potential impact is in the form of higher payments from banks to Deposit Guarantee Schemes in EU member states. The collapse of Sberbank in Austria already has resulted in a deposit guarantee payout event, likely to result in higher deposit guarantee fees for Austrian banks. The authorities are now reported by Bloomberg to be looking for alternative solutions for another European subsidiary of a Russian bank, that may result in higher costs for German banks. These events come ahead of the expected update of the European Crisis Management and Deposit Insurance framework later this year, at which the rule book for bank failures in the European Union will be presented.

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