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BRIEFING

# Thematic analyses: Country-specific recommendations on banking issues 2011-2017

*This briefing focuses on the banking recommendations addressed by the Council to individual Member States within the framework of the European Semester over the past years. It takes a rather broad approach and covers all recommendations targeting individual Member States' banking sectors from a financial stability perspective or in respect of the financing of their economies and access to finance. It takes stock of these banking relevant country specific recommendations issued since 2011, looks in detail at the main topics addressed and gives an overview of the implementation by Member States as assessed by the Commission. The briefing is regularly updated.*

## OVERVIEW OF THE BANKING CSRS

**Over the period 2011-2017 the Council has addressed more than 80 country-specific recommendations (CSRs) to Member States relating to banking services and financial stability** (hereafter 'banking CSRs'). Altogether, 20 Member States have been targeted in this respect over the period under review, of which 14 belong to the euro area (see Chart 1 below). The 2017 CSR were formally adopted by the Council, on the basis of the Commission's recommendations, on 11 July 2017.

**CHART 1: BANKING CSRS BY MEMBER STATE**

| BE | BG | DK | DE | IE | ES | HR | IT | CY | LV | LT | LU | HU | MT | NL | AT | PT | SI | SE | UK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | | | | | | 2017 | 2017 | |
| | | | | | | | | | | | | | | 2017 | | | 2016 | 2016 | |
| | | | 2016 | | 2015 | | 2017 | | | | | | | 2016 | | | 2015 | 2015 | 2015 |
| | | | 2014 | 2017 | 2014 | | 2016 | 2017 | | | | 2015 | | 2015 | 2015 | 2017 | 2014 | 2014 | 2014 |
| | 2017 | | 2013 | 2016 | 2013 | 2016 | 2015 | 2016 | | | | 2014 | 2015 | 2014 | 2014 | 2016 | 2013 | 2013 | 2013 |
| 2012 | 2016 | | 2012 | 2015 | 2012 | 2015 | 2014 | 2012 | | | | 2013 | 2013 | 2013 | 2013 | 2015 | 2012 | 2012 | 2012 |
| 2011 | 2015 | 2011 | 2011 | 2014 | 2011 | 2014 | 2013 | 2011 | 2013 | 2016 | 2016 | 2011 | 2012 | 2012 | 2012 | 2014 | 2011 | 2011 | 2011 |

*Source: EGOV based on CSRs adopted by the Council in 2011-2017*

**It should be noted that Member States under a macroeconomic adjustment programme are not subject to the European Semester surveillance framework.** Instead programme conditionality is enshrined in a specific Memorandum of Understanding. Hence Greece has never received any recommendation as part of the Semester; Cyprus received a banking CSR in 2011 and 2012 (i.e. before the start of its programme in 2013) and in 2016 and 2017 (following the completion of the programme); and Ireland started receiving recommendations in 2014 after exiting its programme in 2013. As an exception, Spain has always been integrated into the European Semester, on account of the narrow scope, small size and short duration of the Spanish programme (which was circumscribed to the recapitalisation and restructuring of the banking sector).

**In general, Member States that have received banking CSRs have been targeted several years in a row.** There are very few cases (Denmark in 2011 and Latvia in 2013) of banking CSRs being issued on a 'one-off' basis. Since 2011, two Member States have received a banking CSR each year, i.e. six years in a row (Slovenia and Sweden). Seven Member States have never received any CSRs relating to their banking sectors: France, Finland, the Czech Republic, Slovakia, Romania, Poland and Estonia.


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## TOPICS ADDRESSED BY BANKING CSRS

**It is possible to identify recurring topics in banking CSRs.** Four main themes are particularly prominent:

- CSRs addressing *structural weaknesses* in Member States' banking systems (aimed at enhancing banking supervision, strengthening banks' capital adequacy where structurally low or fostering the restructuring of the banking sector, for example);
- CSRs addressing *cyclical vulnerabilities* such as overvalued housing prices owing to excessive credit growth (a housing bubble);
- CSRs pointing to the high level of *non-performing loans* (NPLs) on bank balance sheets and/or to the shortcomings of *national insolvency frameworks*;
- CSRs relating to *access to finance* and the financing of the economy.

**The focus of banking CSRs has evolved over time.** In the early days of the European Semester, in 2011-2012, priority was clearly given to the stabilisation of the financial system in general. Many recommendations targeted the quality of banking supervision or recapitalisation needs of the banking system (structural weaknesses). In more recent years, the focus has shifted to access to finance and growth, and to the need to reduce the amount of NPLs on bank balance sheets in order to free up lending capacity.

**The establishment of the Banking Union in 2014 marked a turning point as regards the scope of banking CSRs:** since then, far fewer banking CSRs relating to structural weaknesses have been issued to euro area Member States. The Commission communication of 24 November 2015 entitled 'Towards the completion of the Banking Union' confirms that addressing NPLs is now a priority of the Semester: '*In the context of the European semester the Commission will also call for increased attention from Member States to settle NPLs, including by upgrading insolvency regimes towards best practices*.' The Commission reflection paper on the deepening the Economic and Monetary Union published in May 2017 confirmed such priority. The Council addressed a recommendation relating to NPLs to CY, IE, IT, PT, SI and HR in 2016 and to BG, IE, IT CY, PT and SI in 2017 (a detailed overview of the areas of concern by Member State can be found in Annex 2).

**A certain geographical divide can be identified.** It appears that recommendations relating to cyclical vulnerabilities and excessive credit growth and/or private-sector debt have been predominantly, if not exclusively, addressed to Member States in the northern part of Europe (the United Kingdom, the Netherlands, Denmark, Sweden and Latvia), while Member States further south have received recommendations targeting the structural weaknesses of their banking systems instead, i.e. weaknesses in banking supervision or banks' governance, banks' insufficient levels of capital, and the need to restructure the small and medium-size banking sector or reduce the high level of NPLs (Spain, Italy, Portugal, Bulgaria and Cyprus). A noteworthy exception is Germany, which has been recommended several times to restructure its *Landesbanken* sector.

## IMPLEMENTATION OF BANKING CSRS

Compared with the average implementation rate for all CSRs (see EGOV briefings covering 2016 CSRs, 2015 CSRs, 2014 CSRs and 2013 CSRs), the **level of implementation of policies addressed in the banking CSRs, as assessed by the Commission in its country reports since 2012, was overall reasonably satisfactory until 2015**. It however declined sharply in 2016 (See table 1 below).Over the period 2012-2016, the percentage of banking CSRs that led to no or limited progress amount to 24.3 %. As shown in Table 1, the implementation rate of banking CSRs has varied over time. In the early days of the Semester, the implementation rate was low (only 16.7 % of the 2012 CSRs were fully or substantially implemented). The implementation rate reached a peak in 2013 (40 % of the 2013 banking CSRs were fully or substantially implemented). In 2014 and

2015, around a quarter of banking CSRs were fully or substantially implemented. In 2016, no banking CSRs were in that category.

### TABLE 1: PROGRESS IN THE IMPLEMENTATION[1] OF BANKING CSRS

| YEAR | FULL/SUBSTANTIAL | NO/LIMITED | SOME PROGRESS |
|---|---|---|---|
| 2016 | 0 % | 60.0 % | 40.0% |
| 2015 | 23.1 % | 7.7 % | 69.2 % |
| 2014 | 26.7 % | 33.3 % | 40.0 % |
| 2013 | 40.0 % | 20.0 % | 40.0 % |
| 2012 | 16.7 % | 0.0 % | 83.3 % |
| **2012-2016** | **22.7 %** | **24.3 %** | **53 %** |

*Source: European Commission country reports 2013-2017, EGOV calculations. Note: There has been no explicit assessment by the Commission of the level of implementation of the 2011 CSRs, which are hence not covered in the table and chart (nor are the recently adopted 2017 CSRs).*

**This overall picture hides contrasting situations at country level.** Table 2 overleaf gives an overview of the level of implementation by Member State, as assessed by the Commission in its successive country reports. The level attained corresponds to the overall assessment by the Commission's services of the implementation of the last banking CSRs received by the country, the year of which may differ from country to country[2]. The following conclusions can be drawn:

- The level of implementation does not seem to be linked to the size of the country. Both small countries – Latvia – and large ones –Spain – may perform well, and small countries – Luxembourg – and large ones – Germany – may make only limited progress as regards CSRs implementation;
- High implementation rates are not necessarily linked to a specific type of banking CSR; some Member States that had to address structural weaknesses in their banking sector performed well (Belgium, for example). Cyclical vulnerabilities can be difficult to overcome (in Sweden, for example).
- Member States in the euro area have not performed worse or better than other EU Member States; being part of the Banking Union, they are nonetheless in a specific situation as the

[1] The following categories were used to assess progress in implementing the 2016 country-specific recommendations:
**No progress:** The Member State has not credibly announced nor adopted any measures to address the country-specific recommendation. Below a number of non-exhaustive typical situations that could be covered under this, to be interpreted on a case by case basis taking into account country-specific conditions:
• no legal, administrative, or budgetary measures have been announced in the National Reform Programme or in other official communication to the national Parliament / relevant parliamentary committees, the European Commission, or announced in public (e.g. in a press statement, information on government's website);
• no non-legislative acts have been presented by the governing or legislator body;
• the Member State has taken initial steps in addressing the country-specific recommendation, such as commissioning a study or setting up a study group to analyse possible measures that would need to be taken (unless the country-specific recommendation explicitly asks for orientations or exploratory actions), while clearly-specified measure(s) to address the country-specific recommendation has not been proposed.
**Limited progress:** The Member State has:
• announced certain measures but these only address the country-specific recommendation to a limited extent; and/or
• presented legislative acts in the governing or legislator body but these have not been adopted yet and substantial non-legislative further work is needed before the country-specific recommendation will be implemented;
• presented non-legislative acts, yet with no further follow-up in terms of implementation which is needed to address the country-specific recommendation.
**Some progress:** The Member State has adopted measures that partly address the country-specific recommendation and/or the Member State has adopted measures that address the country-specific recommendation, but a fair amount of work is still needed to fully address the country-specific recommendation as only a few of the adopted measures have been implemented. For instance: adopted by national parliament; by ministerial decision; but no implementing decisions are in place.
**Substantial progress:** The Member State has adopted measures that go a long way in addressing the country-specific recommendation and most of which have been implemented.
[2] 2017 CSR have not been included as these have just been formally adopted and their implementation has de facto not been assessed by the Commission yet.

European Central Bank (ECB) became responsible for the supervision of their banks – directly or indirectly – as of November 2014 when the Single Supervisory Mechanism became fully operational.

**As shown in Table 2, nine Member States have made no progress or only limited progress** in the implementation of (at least one of) the last banking CSRs received. These are Bulgaria (2016), Sweden (2016), Germany (2016), Croatia (2016), Lithuania (2016), Luxembourg (2016), The Netherlands (2016), Portugal (2016) and Cyprus (2016).

**Three Member States have implemented the last banking CSRs addressed to them in full** or substantially - Belgium (2012), Latvia (2013), and Spain (2015):

- Belgium was targeted in the early years of the Semester because of structural weaknesses in its banking sector linked in particular to the Dexia case, which have since been addressed;
- Latvia has received only one banking CSR, in 2013, the year before it joined the euro, owing to rising cyclical vulnerabilities; according to the Commission’s assessment, Latvia has managed to rein in its excessive credit growth;
- Spain had made progress in restructuring its banking sector as a result of the Spanish programme;

**The bulk of the addressees – eight Member States – have made ‘some progress’** in implementing the last banking CSRs received: Denmark (2011), Austria (2015), Hungary (2015), Italy (2016), Malta (2015), Ireland (2016), Slovenia (2016) and UK (2015). In Table 2, Italy has been classified in the ‘yellow’ category as the Commission’s overall assessment was that “some progress” has been made in the banking sector while progress were only limited as regards the handling of NPLs more specifically.

**Table 2: Implementation of banking CSRs by Member State 2012-2016**

| | Last banking CSRs received (year, number) | Overall implementation rate |
|---|---|---|
| BE | 2012, CSR3 | Full/substantial |
| BG | 2016, CSR2 | Some progress |
| | 2016, CSR4 | No/limited |
| DK | 2011, CSR5 | Some progress |
| DE | 2016, CSR2 | No/limited |
| IE | 2016, CSR3 | Some progress |
| ES | 2015, CSR2 | Full/substantial |
| HR | 2016, CSR5 | No/limited |
| IT | 2016, CSR3 | Some progress |
| CY | 2016, CSR2 | No/limited |
| | 2016, CSR3 | Some progress |
| | 2016, CSR4 | Some progress |
| LV | 2013, CSR2 | Full/substantial |
| LT | 2016, CSR3 | No/limited |
| LU | 2016, CSR2 | No/limited |
| HU | 2015, CSR2 | Some progress |
| MT | 2015, CSR4 | Some progress |
| NL | 2016, CSR3 | No/limited |
| AT | 2015, CSR4 | Some progress |
| PT | 2016, CSR4 | No/limited |
| SI | 2016, CSR3 | Some progress |
| SE | 2016, CSR1 | No/limited |
| UK | 2015, CSR2 | Some progress |

*Source: European Commission country reports 2013-2017, EGOV calculations. Note: The colour coding corresponds to the overall assessment by the Commission's services of the level of implementation of the last banking CSRs received by the country and assessed by the Commission, the year of which may differ from country to country.*

## Some conclusions

- The level of implementation of the banking CSRs -while on average superior to the implementation rate of all CSRs over the period 2012-2016- declined sharply in 2016;
- The establishment of the Single Supervisory Mechanism and the Banking Union constitutes a turning-point which resulted in far fewer banking recommendations on structural weaknesses addressed to euro area Member States, with a few exceptions (the recommendations issued to Germany concerning the *Landesbanken*, for example);
- There is no obvious correlation between the size of the banking system and the level of implementation of the banking CSRs: small systems are not necessarily easier to reform than large ones;
- The focus of the banking CSRs has evolved over time and has shifted from financial stability to growth and access to finance;
- Some banking CSRs have been discontinued, despite the implementation by the Member State not being assessed as satisfactory (in Denmark and Germany);
- Since the establishment of the Banking Union, national supervisors have been fully integrated into the Single Supervisory Mechanism and the ECB is now directly responsible for the supervision of the most significant banks in the euro area; one may argue that this institutional change has made the interpretation of some banking related CSRs more complex, as they remain addressed to individual countries while the responsibility of banking supervision has been transferred to the European level.

## ANNEX 1: SAMPLE OF BANKING CSRS IN THE PERIOD 2011-2017

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | TOTAL |
|---|---|---|---|---|---|---|---|---|
| **BG** | | | | | CSR2 | CSR2,4 | CSR2 | **4** |
| **BE** | CSR3 | CSR3 | | | | | | **2** |
| **DK** | CSR5 | | | | | | | **1** |
| **DE** | CSR2 | CSR2 | CSR4 | CSR4 | | CSR2 | | **5** |
| **IE** | | | | CSR5,6 | CSR4 | CSR3 | CSR3 | **5** |
| **ES** | CSR3 | CSR4 | CSR3 | CSR2 | CSR2 | | | **5** |
| **HR** | | | | CSR7,8 | CSR6 | CSR5 | | **4** |
| **IT** | | | CSR3 | CSR4 | CSR4 | CSR3 | CSR3 | **5** |
| **CY** | CSR2 | CSR2 | | | | CSR2,3,4 | CSR3 | **6** |
| **LV** | | | CSR2 | | | | | **1** |
| **LT** | | | | | | CSR3 | | **1** |
| **LU** | | | | | | CSR2 | | **1** |
| **HU** | CSR5 | | CSR2 | CSR2 | CSR2 | | | **4** |
| **MT** | | CSR6 | CSR5 | | CSR4 | | | **3** |
| **NL** | | CSR5 | CSR2 | CSR2 | CSR2 | CSR3 | CSR1 | **6** |
| **AT** | | CSR7 | CSR7 | CSR5 | CSR4 | | | **4** |
| **PT** | | | | CSR5 | CSR4 | CSR4 | CSR3 | **4** |
| **SI** | CSR3 | CSR3,6 | CSR4,5,9 | CSR4 | CSR3 | CSR3 | CSR3 | **10** |
| **SE** | CSR2 | CSR2 | CSR2 | CSR2 | CSR1 | CSR1 | CSR1 | **7** |
| **UK** | CSR2,5 | CSR2,5 | CSR2,5 | CSR2,5 | CSR2 | | | **9** |
| **TOTAL** | **10** | **12** | **14** | **15** | **13** | **15** | **8** | **87** |

*Source: EGOV based on the CSRs adopted by the Council in the period 2011-2017*

## ANNEX 2: MAIN TOPICS COVERED IN THE 2011-17 BANKING CSRs

| | MAIN TOPIC(S) | CSR YEAR(S) |
|---|---|---|
| **BE** | Structural weaknesses | 2011, 2012 |
| **BG** | Structural weaknesses<br>NPL/insolvency frameworks | 2015, 2016, 2017 |
| **DK** | Cyclical vulnerabilities | 2011 |
| **DE** | Structural weaknesses<br>Access to finance | 2011, 2012, 2013, 2014, 2016 |
| **IE** | NPL/insolvency frameworks<br>Access to finance | 2014, 2015, 2016, 2017 |
| **ES** | Structural weaknesses<br>NPL/insolvency frameworks<br>Access to finance | 2011, 2012, 2013, 2014, 2015 |
| **HR** | Structural weaknesses<br>NPL/insolvency frameworks | 2014, 2015, 2016 |
| **IT** | Structural weaknesses<br>NPL/insolvency frameworks<br>Access to finance | 2013, 2014, 2015, 2016, 2017 |
| **CY** | Structural weaknesses<br>NPL/insolvency frameworks | 2011, 2012, 2016, 2017 |
| **LV** | Cyclical vulnerabilities | 2013 |
| **LT** | Access to finance | 2016 |
| **LU** | Access to finance | 2016 |
| **HU** | Structural weaknesses<br>NPL/insolvency frameworks<br>Access to finance | 2011, 2013, 2014, 2015 |
| **MT** | Cyclical vulnerabilities<br>NPL/insolvency frameworks | 2012, 2013, 2015 |
| **NL** | Cyclical vulnerabilities | 2012, 2013, 2014, 2015, 2016, 2017 |
| **AT** | Structural weaknesses | 2012, 2013, 2014, 2015 |
| **PT** | Structural weaknesses<br>NPL/insolvency frameworks<br>Access to finance | 2014, 2015, 2016, 2017 |
| **SI** | Structural weaknesses<br>NPL/insolvency frameworks<br>Access to finance | 2011, 2012, 2013, 2014, 2015, 2016, 2017 |
| **SE** | Cyclical vulnerabilities | 2011, 2012, 2013, 2014, 2015, 2016, 2017 |
| **UK** | Cyclical vulnerabilities<br>Access to finance | 2011, 2012, 2013, 2014, 2015 |

*Source: EGOV thematic analysis based on the CSRs adopted by the Council in the period 2011-2017*