

“European Deposit Insurance Scheme implementation: pros and cons”

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EUROPEAN DEPOSIT INSURANCE SCHEME IMPLEMENTATION: PROS AND CONS

Abstract

The creation of deposit insurance systems in world practice has become a tool for solving problems of maintaining the stability of banking systems, increasing customer confidence in banks and other credit institutions, and preventing cases of mass withdrawal of deposits during economic crises. The paper aims to examine why such an important pillar of the banking union as the European Deposit Insurance Scheme (EDIS) has not yet been implemented. The deadlock in the EDIS negotiations is unprecedented, and the likelihood that the agreement towards this pillar will be reached is rather low. The main reason for its blocking is the existing differences of interests between the main actors, and as a consequence, it makes the progress towards the completion of this process impossible. This study attempts to structure these interests, and it seems that the necessary tool to help bring them together is the concept of moral hazard. The results obtained confirmed the hypothesis that the main barrier for EDIS introduction is the severe difference of interest between countries that can be potentially major contributors and those that hope to benefit from that. Moreover, one of the arguments for such a delay is that cross-border subsidization leads to the problem when the country with better economic indicators pays for the debts of weaker economies as the costs should be socialized.

Keywords

EDIS, banking union, moral hazard, crisis, banking
integration

JEL Classification

F36, F53, G21, G22

INTRODUCTION

Among the components of the economic and monetary union, the creation of a banking union is perhaps the least controversial and enjoys the greatest support. This is no coincidence, because it is the banking sector that is today the most globalized sector of the economy and, at the same time, the sector where the most powerful waves of economic destabilization emerge. For the Eurozone, as well as for the European Union (EU), the issues of banking sector consolidation are extremely relevant, but nowadays experts note the presence of obvious destabilizing factors in this area (Storm, 2017). In particular, the viability of the existing banking system in the Eurozone, which suffers from structurally low profitability and significant volumes of problem loans, is of crucial concern. For example, Italian banks have more than EUR300 billion of such loans, or almost 1/5 of all loans issued in the country.

At the same time, the German economy – the largest and strongest in the Eurozone – is also struggling with a banking crisis: For example, the country's largest bank, Deutsche Bank AG, was identified by the IMF in 2016 as a bank that is a source of systemic risk for the global financial system (IMF, 2017). And although in recent years the monetary stimulus measures adopted by the European Central Bank (ECB)

– conducting operations in the open money market (buying sovereign bonds of the Eurozone countries in secondary markets) and introducing a long-term refinancing program – somewhat strengthened the banking sector and allowed, in particular, reducing the spreads of interest rates on bonds for Italy, Spain and Portugal, and also helped prevent bankruptcy of a number of banks, this was achieved not by institutional strengthening of the banking system, but by artificially increasing liquidity (Storm, 2017).

At the moment, the following achievements can be observed: The EU has two fully operational pillars, the first one is the Single Supervisory Mechanism (SSM), a new approach of banking supervision for Europe. It consists of the ECB and the national supervisory authorities of the member states, which provide consistent supervision based on knowledge-sharing path and with the aim of ensuring the protection and sustainability of the European banking system in order to increase financial integration and stability in the Eurozone. The second pillar is the Single Resolution Mechanism (managed by Single Resolution Board). The SRM is an instrument responsible for providing orderly resolution of failing banks with the minimal cost for both taxpayers and the economy. The SRM is also in charge of the application of a common set of rules and manages the European Single Resolution Fund (ESRF) fully funded by the industry (Kuznichenko et al., 2018). However, the third and the last pillar of a banking union is the European Deposit Insurance Scheme (EDIS), which was supposed to provide a solid and more constant degree of insurance coverage in the Eurozone. Therefore, the problem of delaying the European deposit insurance scheme will be considered in terms of moral risk theory.

1. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

There are many studies in the economic literature on the need to create EDIS within a banking union.

After the financial and economic crises that erupted in 2007–2009, it was observed that the financial sector in Europe was still vulnerable and did not function reliably. After the 2008 banking crisis, banks have been struggling for their future (Menrad, 2020). Obviously, in the monetary union such as the Eurozone, problems caused by close links between public sector finance and the banking sector can easily transcend national borders and cause financial distress in all member states.

The following euro area sovereign debt crisis increased the difficulties of banks. The government bonds they held turned into risky assets (Golab et al., 2018). The financial crisis and debt crises in the euro area left European banks with EUR1.0 trillion of non-performing loans (NPLs) (Figure 1).

This harmed banks, borrowers and the European economy as a whole (Demertzis et al., 2017). Finally, regulators and supervisors have failed to follow market developments, and the crisis showed that

coordination between the supervisory institutions was not sufficient in the context of the single currency. Thus, EU leaders agreed that there was a need to create a safer framework for the single market in the banking sector in order to avoid the further potential crises and a situation when banks were exploiting the benign environment by seeking higher returns, with little concern for the risks. The wholeness of these initiatives was included in the project of the banking union (EP, 2019).

The European Council published a document on the necessity of creating the banking union in June 2012 to put the banking sector on the solid basis, recover the trust towards the euro by reducing market fragmentation, prevent situations when the money of taxpayers was used for saving the failed banks, as well as ensure the sustainability of the banks and ability to resist any further financial crises (Mersch, 2013).

Transferring the supervision over the banks on the European level is the key element of this process, which consequently should be united within other steps, such as a common system for deposits' protection and integrated bank crisis management (Rompuy, 2012).

Kuznichenko et al. (2018) developed methodical approaches to the assessment and supervision of

Source: Statista (2019).

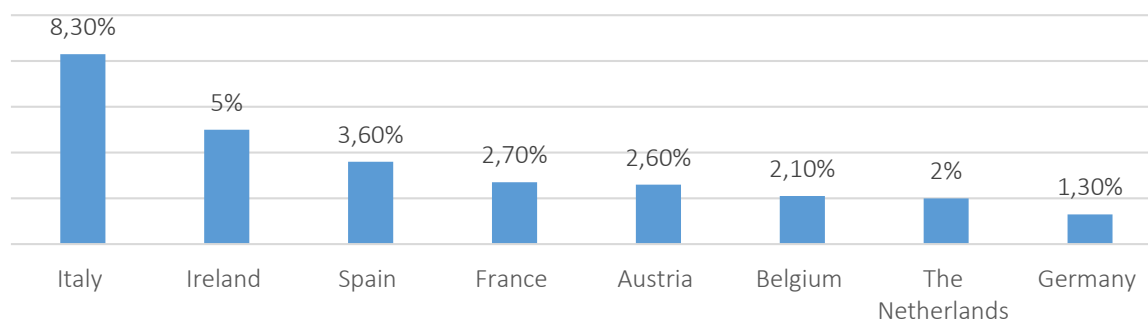


Figure 1. NPL ratio in Western Europe (March 2019)

the banking market risk (in particular, the SA, IMA and R-SbM approaches) recommended by the Basel Committee on Banking Supervision in terms of standardization and unification of the regulatory framework for capital requirements.

Former German Finance Minister Wolfgang Schäuble stressed that the banking union seems to be the most ambitious European project since the introduction of the single European currency (Schäuble, 2015). By returning Europe to the correct path of integration, the banking union will resume its movement towards an authentic economic and monetary union.

In November 2015, the process of creating the Banking Union received a new impetus when the European Commission's message "Towards the completion of the Banking Union" was published (European Commission, 2015a). It was suggested:

- 1) to introduce a general deposit insurance scheme within the Banking Union, as one of the three (along with SSM and SRM) of its main pillars (pillars), first based on a reinsurance approach, which will gradually be turned into a full-fledged insurance scheme over several years;
- 2) to start work to strengthen the agreed bridge financing mechanism ("financial bridges" (EC, 2017a) to support the Single Remediation Fund (SRF) system during its formation; and
- 3) to start work on the development of a common backstop lending mechanism to distribute banking risks among member countries.

At the same time, the European Commission has formulated detailed proposals for the implementation of the European Deposit Insurance Scheme (EDIS) for bank deposits (EC, 2015b). In turn, this unified system is based on the system of national deposit insurance schemes, the key parameters of which are regulated by Directive 2014/49/EU (EU, 2014) and provide mandatory for all banks of the EU member states (including branches of banks established in other member countries) protection of all deposits. It is assumed that the guaranteed amount of compensation will be EUR 100.000 for all deposits of one depositor – an individual in one banking institution. It is important that the insurance "fund" is formed at the expense of deductions from the banking system, and not taxpayers' funds. The EDIS initiative aims to provide guarantees for payments in all member countries of the euro area, thereby reducing the vulnerability of deposits to external shocks and increasing the level of confidence in national banks in different parts of the euro area. It is assumed that the role of the former will increase over time in the interaction between EDIS and the respective national deposit insurance systems – until the full transition to the EDIS system.

An important step on this path was the decision of the EU Council on June 17, 2016 on the Roadmap for completing the formation of a banking union, developed by the European Commission in September 2012 (EC, 2012). The goal was to complete the formation of the banking union in 2019, but due to the lack of necessary measures in the original plan, this idea was not implemented. Despite this, in 2017, new initiatives were put forward aimed at giving the process of forming a banking union a more complete form. They were

contained in the EC Communication of 2017 (EC, 2017a, 2017b), which envisaged not only the introduction of the EDIS system, but also banking union instruments such as mechanisms for the settlement of problem loans (Non-performing loans) and the introduction of framework conditions for bank investments in securities secured by a diversified portfolio of bonds of the central governments of the Eurozone countries (a framework for developing Sovereign Bond-Backed Securities, SBBS). It also consolidated the adoption of measures to introduce a common backstop instrument in the European Stability Mechanism (ESM).

In May 2018, the EU Council adopted a comprehensive package of EC proposals aimed at increasing the resilience of the EU banking sector by complementing the already functioning elements of the banking union. In particular, the Capital Requirements Regulation (CRR; Capital Requirements Directive, CRD) adopted in 2013, the Bank Recovery and Resolution Directive (BRRD) adopted in 2014, and the Regulation on the Single Resolution Mechanism Regulation (SRMR) (EC, 2018).

Moral hazard also paves the way for some banking systems to be more likely use EDIS funds than others, even if all banking systems benefit from the enhanced capacity of the deposit scheme to withstand larger crises (Abascal et al., 2015).

This study will attempt to prove hypothesis (H_0) that the main obstacle to EDIS introduction is the severe difference of interest between countries that can be potentially major contributors and those that hope to benefit from that.

2. GENERALIZATION OF THE MAIN STATEMENTS

The moral hazard came originally from the insurance industry as insurance companies fear that proposing pay-outs to protect individuals or institutions against losses from accidents may provoke risk-taking and, as a result, they need to pay more in claims. Many insurers claim that the realization of the factor that something is insured leads, for

example, to situations where policyholders with collision insurance drive recklessly or fire-insured homeowners smoke in bed (Van Wolferen et al., 2013, pp. 11-22).

In the insurance industry, moral hazard theory represents what happens when one side is partially isolated from risk because the other party agrees fully or partially compensate for losses that may be incurred by the first party. The key point of moral hazard theory is that insurance completely or partially removes the incentives that restrict the use of insured services. With full coverage, when 100% of the costs is covered, there is no financial reason for someone with insurance not to visit the doctor. Oliynyk et al. (2017) considered the issues of moral hazard compensation in the aspect of life insurance and death insurance.

It is also worth noting that information asymmetry is the basis of moral hazard theory. This asymmetry arises because the insurer does not possess sufficient information on the state of health and the reasons for insurance of the insured side. For example, the insurer cannot check if the visit to the doctor was made without insurance (when the visit would cost the insured more), or because of some risks that could have been avoided. The insured could even fake his doctor visit in order to obtain money from the insurance company. In each of these examples, the insurer is unable to perfectly observe the risks that the insured takes and adjust the contract accordingly. These risks should be under the control of the insured. If moral hazard is likely to arise, the insurer prefers the insured to take precautions to avoid risks, but cannot prevent its occurrence. The insured can take risks without being assessed in the insurance contract and, as a result, its asymmetry can lead to a wider use of insured services. If insurance companies can directly observe the actions of their clients, they can refuse to cover clients who choose risky actions. For example, smoking in bed or unfastened seat belts, which allows them to strengthen protection against the risk of fire or accidents, not encouraging risky behavior. Nevertheless, since insurance companies cannot fully monitor the actions of their clients, they are not recommended to provide the level of protection that would be provided in the world with perfect information (Bohn & Hall, 1997, pp 2-15).

Another example when the moral hazard occurs under the influence of information asymmetry is when the party accepting the risk knows more about its intentions than the party that pays for the consequences of the risk and has a tendency or incentive to take too much risk for the party with less information. This special case of moral hazard is called the problem of the principal-agent or agency problem developed by Stephen Ross and Barry Mitnick (Odintsova, 2009, p. 159). The problem here appears due to the asymmetry of information, which consists of the presence of two conditions:

1. The agent's activities are not directly observable by the principal.
2. The activities of an agent cannot be judged by its final results.

A principal may be at risk of serious loss. His well-being depends on the actions of the agent. Costs in agent relations consist of the following components:

1. costs of control by the principal;
2. costs of the contractor associated with the voluntary adoption of more stringent conditions, for example, the costs of making a deposit; and
3. residual losses, that is, the principal's losses from the agent's decisions, deviations from decisions that the principal himself would have made if he had the agent's information and abilities (Odintsova, 2009, pp. 160-165).

In 1997, renowned American sociologist and Nobel prize-winner Robert Merton first noticed the negative incentive effects of the deposit insurance and showed how deposit insurance stimulated banks to invest in risky assets. He stressed that the reason for this was the existence of moral hazard: this term is often used in the insurance area and can occur in various scenarios, one of which is directly related to deposit insurance schemes. Deposit insurance can encourage depositors to choose a bank, without any concerning the business practice of its managers. In such a case, it frees managers and shareholders from the pursuit of higher

profit, by investing in portfolios with the high risk that their uninsured depositors are ready to accept. This high risk is called moral hazard, and it has been stressed by many scientists and politics, however, was underestimated (Merton, 1997, pp. 3-25).

How can this observation refer to EDIS? A well-designed system of financial security promotes a stable financial system. However, if it is badly designed, it can lead to higher risk and moral hazard. In other words, insured institutions should use insured deposits with the lower costs to exercise the projects or actions with a higher extent of risk than it is optimal. That is possible when depositors and other shareholders ignore risky behavior of insured institution as they are protected from the losses or assume that insured institution will not be able to fail.

Therefore, moral hazard is a problem for all member states inside the security network, and the reduction of the volume of moral hazard is a crucial element of the security network design.

The introduction of common guarantee scheme may give confidence that insured deposit institutions will not be able to face the failure and may influence the incentives of shareholders, depositors, creditors, stakeholders, the management board of the banks and directors so that to control the activity of the insured institution and discipline the risk of the insured institution. Depositors whose assets are insured often limit the access to the necessary information or skills for the monitoring of insured institutions (Merton, 1997, pp. 25-60).

The contractors of deposit guarantee scheme are states and banks, due to the banks' sovereign nexus, their interests are merging; it means that if EDIS is introduced, moral hazard in this instance would mean that both the member states' and banks' interest and behavior may change in an undesirable way, since the cost of bank failures will be socialized. This is because when depositors are protected by a supranational deposit insurance scheme, participating countries may be less strict with national banking policies.

Regarding the challenging process of negotiations towards EDIS introduction, it is worth noting that an agreement has not been reached so far, since

different member states have different position towards this project. One can say that there is a coalition of countries that are lobbying the progress on EDIS introduction, while there are some states that are opposed to this initiative and constantly block the promotion of this project.

The governments of Germany, the Netherlands, Austria, Belgium and Finland assume that their banking sectors are stronger than the sectors of other participating states of the Eurozone. Since the cost of bank failures is going to be socialized, the perspective of their banks will encourage their depositors to pay for the risks of depositors in countries with weaker banking sectors, and therefore, with higher risks. In 2016, the government of Finland pointed that the difference between the states in regulating the banking sector and risks is so huge that the benefits and costs of the European Deposit Insurance Scheme will be unequally shared. For some non-Eurozone countries, for example, Great Britain and Sweden, where the Treasury or the Central Bank provide financial support for deposit insurance schemes, the pan-EU scheme and borrowing mechanism were also unacceptable due to potential consequences for the governmental wallet and therefore taxpayers. The British government opposed the proposal for mutual borrowing in the revised Deposit Guarantee Scheme, as it can create unpredictable and unacceptable financial risk for the UK Treasury.

Also, some northern European governments indirectly expressed concerns. For example, the government of The Netherlands stated that the last condition for the full burden-sharing consisted in banks that should participate in European Deposit Insurance, and the Resolution Fund should have equal starting positions. Before the banks will be able to claim European resolution and depos-

it guarantee, their financial conditions should be comparable (Garcia & Prast, 2003, pp. 37-48).

But, the most explicit opposition towards the EDIS implementation came from the government of Germany. Germany criticized the proposal of the European Deposit Insurance Scheme as an unacceptable step towards debt mutualization. The majority of political parties in Germany opposed it. The former Minister of Finance Wolfgang Schäuble said that the backstopping of depositors could become a pretext for the banks to behave irresponsibly and that it potentially would force German taxpayers to pay all the bills. The important criteria, which qualify the German side of the moral hazard contract, is the level of public debt. The German government debt level was always one of the lowest in Eurozone, this is one of the indicators characterizing a strong and stable economy. However, it should be noted again that after the sovereign nexus crises, the German government debt significantly increased and only in the last three years has decreased to its prior level. As of now, Germany has returned to the position of a country with one of the lowest debt levels (Figure 2).

Unlike this, France and euro area periphery countries, such as Italy and Spain, considered EDIS as the third pillar of the Banking Union, so that to sever the doom loop between banks and sovereigns and preventing deposit flights in countries suffered from the sovereign debt crisis. For instance, the Italian government has repeatedly pointed out the need to complement the Single Supervisory Mechanism with the Single Resolution Mechanism and European Deposit Insurance Scheme, since coherence is necessary to agree between centralization of supervision and management of financial difficulties for the

Source: Statista (2020).

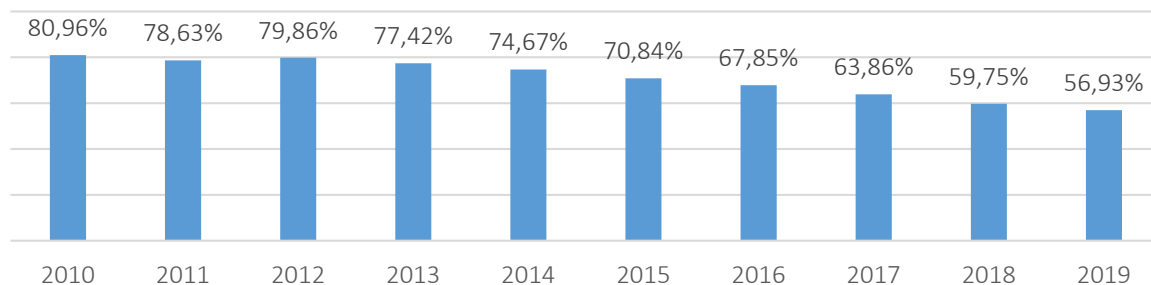


Figure 2. German evolution of national debt

achievement of purposes of the banking union. Likewise, the Spanish government underlined the necessity to agree the basis and the date, when EDIS should finalize the banking union. However, these countries concentrated their efforts only on creating the Single Resolution Mechanism and Single Resolution Fund rather than lobby for the European Deposit Insurance Scheme (Heller & Strupczewski, 2015). In this way, one of the reasons for the delay is lack of the compromise towards EDIS between the member states and its different political orientations and interests.

To sum up all the arguments mentioned above, one can confidently conclude that moral hazard provides an explanation on why EDIS is not operational yet, and this concept introduces the existence of a conflict of interest between payers and hazarders in the scheme. The Eurozone member states have split on the two different fractions towards the question related to implementing a single European Deposit Insurance Scheme: The states such as Germany, the Netherlands, Belgium, Austria and Finland may be treated as opponents of this initiative, while Italy, Spain and France are its proponents.

3. DISCUSSION

This section considers all pros and cons concerning the implementation of the European Deposit Insurance Scheme.

It is worth noting that the German position towards completing a banking union has recently softened a bit. On the 6th of November 2019, the German minister of finance Olaf Scholz, who was always blamed by people due to the blocking of progress towards the European Deposit Insurance Scheme, expressed his ideas on how to complete the banking union. He proposed a new European Deposit Reinsurance Scheme to improve these national accords. The idea of this is that in a case of any bank failure, the first resources for depositors will be first the national insurance scheme, and later on, in a situation, if these funds are ended up, the European fund should grant limited supplementary liquidity through repayable loans. If additional financing is needed, then the appropriate sovereign will step in. Such position of the German

finance minister correlated with the mindset of German citizens, who hardly welcomed the idea of sharing their own money to help depositors whose banks are in trouble. Moreover, they are confident about the position that their savings will mostly be shared with the profligate southern European countries (The Economist, 2019).

Scholz's plan is part of a broader package to tackle the problem related to fragmentation, that is weakening European banks on several fronts. It deals with insolvency plans and sovereign debt weighting, as well as tax issues. Scholz's plan appears to be an attempt to unlock the European Deposit Insurance scheme. He wants to complete the Banking union to boost the political weight of the Eurozone on the world stage. However, negotiating it is a long process, since Scholz's plan caught his coalition partners in the German government by surprise. And there are doubts whether there will be enough consensus in Berlin to prolong this initiative (Lee, 2019).

This plan is currently discussed by the Eurogroup because it remains to be unambitious compared to the original plan proposed by the Commission for the European Deposit Insurance Scheme, which covers a gradual process towards a fully integrated European-wide system. To end his opposition toward EDIS, Scholz requires a revision of the sovereign debt treatment considered by the regulator as risk-free assets. European banks must take capital charges against the national sovereign bonds that they have all loaded onto their balance sheets, by these proposals he could offer Germany support for deposit insurance, but only by making it dependent on other European countries, such as most likely Italy, but the other countries also cannot accept it.

Another important issue that Scholz noted in his plan is the necessity to reduce the volume of bad loans in European banks; he said that risk reduction was required for Berlin to move forward to mutualization front. Even though the level of bad loans in Eurozone decreased two times in the last five years, the volume was still high in Italy and Cyprus. The thing that lies behind the latest German proposals is consolidation. Germany's fragmented banking sector needs to have more mergers and acquisitions, and not just in the sav-

ings and cooperative banks. This more applies to their local leaders such as Deutsche Bank and Commerzbank that are coming into the second level among European banks, because they way behind that Benelux, French, Spanish and even Italian large banks (Lee, 2019).

An increase in trust toward the European Deposit Insurance Scheme to avoid the so-called “doom loop” is an advantage of the multinational system of deposit insurance. However, some states can argue if they are afraid that their national subsidiary systems will subsidize other states. Because of the common practice of establishing insurance premiums for the banks to target deposit insurance funds, these fears can be reasonable. However, the European Deposit Insurance Scheme can be structured to significantly decrease subsidies, and the additional benefit will be the decline in moral hazard. These features include the requirement of significant bail-inable equity and debt, providing a systematic risk charge, that is paid by banks to European Stability Mechanism, for its credit line, and risk managing of Deposit Insurance Fund in a way of attracting non-banks to the sharing of risks (Lee, 2019).

At the same banking conference at which the German finance minister took a step forward towards completing a banking union. The conference, at which Scholz proposed a new way to structure EDIS, was immediately followed by the disagreement from several northern countries. Northerners are worried that their taxpayers would be responsible for the risky loans made by southern banks, including their governments. The main reason for this disagreement is that they want to reduce the risk of bank failures across the bloc before jointly guaranteeing deposits.

The proposals of Berlin regarding the EDIS has been immediately triggered by the protests from the Italian side. An explanation for this is that the limits of possessing the sovereign bond are hard to overcome for a country with public debt of over 2 trillion euros (Lee, 2019).

To sum up, if common resolution regimes for all of the European banks support bondholder bail-ins and promote consolidation so that to improve the liquidity of the European banks, then most prob-

ably Germany could agree on a European Deposit Reinsurance scheme, rationalizing that it would be much less damaging than ever before.

The Italian minister of economy said that the risk weights and the provisions they entail, as well as concentration limits on bonds, would put EU banks at a competitive disadvantage to those elsewhere in the world not facing such restrictions. He also mentioned that prudential treatment of sovereign exposures was a measure that would have a negative impact at the international level. The Basel Committee did not call for such modification of the prudential regime to create an unequal playing field on a global level (Strupczewski, 2019a).

The ECB also wants Europe to unilaterally eliminate the zero-risk Eurozone government bonds and signals that this change should occur on the global scale, in order not to put European banks at a disadvantage. The accumulation of more capital to ensure the risk posed by bonds will further increase costs for Eurozone banks that are already trying to make money due to the negative profitability of most governmental debts and negative ECB interest rates.

But all in all, the Italian minister of economy noticed that all discussions based on how to make banks' bondholders more secured should be replaced with another question: How to create a European Safe Asset, which means a bond based on a bond of all Eurozone governments, and it should provide the stability. But it is more than obvious that such proposal on safe assets was strongly refused by the German government because it created a fundament for the moral hazard and could be a first step to the common debt, which Berlin sees as the main danger.

In the meantime, Rome, to make sure that Italian banks will not be in a force to limit the Italian government bond holdings in the future, is threatening to refuse already agreed before European Stability Mechanism reform. The planned change to the ESM reform would reduce the risk that investors will make a more beneficial deal to a potential sovereign debt restructuring and allow a rescue fund to mediate between the sovereign and investors.

In such a way, Italy tries to manipulate and seeks a loophole to not follow a regulatory framework. As Germany already made the first positive step toward the gradual EDIS implementation, by the proposal of the finance minister, it seems that the ice has broken and Germany is ready to negotiations, but whether Italy wants to negotiate? It is clear that these two countries reflect the voice of other states, so countries such as Germany, France, Austria, Benelux will be on the one side, while Italy, Greece and Cyprus on the another (Samitas et al., 2020). The only way

how EDIS can be implemented is the consensus on the question of sovereign bonds and rules of orders how EDIS will operate. Otherwise, given a recent negotiated structure of the European Deposit Insurance Scheme, it is observed that countries with the highest NPL ratio will benefit from the common deposit scheme, mostly because the common fund will be shared across borders. In other words, it is almost impossible for moral hazard to disappear at all if a state continues to play a massive role in the financial world (Strupczewski, 2019b).

CONCLUSION

The main purpose of this paper was to answer the following question: Why such an important pillar of the banking union as EDIS has not yet been implemented? To answer this question, there was a need to disclose the concept of moral hazard and its existence within the deposit insurance framework. Also, an analysis of the banking union structure and all its pillars was provided, which allowed assessing the EDIS delay from the perspective of different states. This study also approached other important questions such as: What are the arguments for this delay? What problem can arise as a result of cross-border subsidization and which member states of the European Union oppose and support EDIS?

In the current economic situation, Germany appeared to be the strongest economy in the European Union, given this fact that there are no potential threats for its banking sector, so if EDIS comes into force, Germany will be the first country to be asked to cover the losses. The reason for this is the cost socialization in the scheme. In contrast, the Italian banking system is going through the difficult times and there is not enough money to cover the country's public debt. Such a situation may provoke the potential usage of the moral hazard loophole if EDIS is fully-fledged by using the means of the common guarantee scheme. This fact answers the question why the German government is against the EDIS initiative in such a framework, while countries in a weaker economic position, such as Italy, found this initiative very convenient as they would be more likely to be beneficiaries of such a scheme.

Finally, to answer the most important question of this work, one can conclude that a compromise on EDIS remains an open issue. The main argument for such a deadlock is the presence of moral hazard within the scheme. The existence of moral hazard is caused by the conflict of interest between the payers and hazarders and, as a consequence, countries' reluctance to compromise. Despite the fact that the introduction of EDIS is beneficial for all the EU member states, since an integrated banking sector makes it possible to hedge against sources of risk and thus smooth income and consumption growth, as well as becoming a source of stability in the face of large financial and economic shocks, no one wants to neglect its interests.

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