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Beyond Moral Hazard Arguments: The Role of National Deposit Insurance Schemes for Member States' Preferences on EDIS[*]

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Abstract

Discussions regarding the planned European Deposit Insurance Scheme (EDIS), the missing third pillar of the European Banking Union, have been ongoing since the Commission published its initial legislative proposal in 2015. A breakthrough in negotiations has yet to be achieved. The gridlock on EDIS is most commonly attributed to moral hazard concerns over insufficient risk reduction harboured on the side of northern member states, particularly Germany, due to the weak state of some other member states' banking sectors. While moral hazard based on uneven risk reduction is helpful for explaining divergent member-state preferences on the scope of necessary risk reduction, this does not explain preferences on the institutional design of EDIS. In this paper, we argue that contrary to persistent differences on necessary risk reduction, preferences regarding the institutional design of EDIS have become more closely aligned. We analyse how preferences on EDIS developed in the key member states of Germany, France, and Italy. In all sampled countries, we find path-dependent benefits connected to the current design of national Deposit Guarantee Schemes (DGS) that shifted preferences of the banking sector or significant subsectors in favour of retaining national DGSs. Overall, given that a compromise on risk-reduction can be accomplished, we argue that current preferences in these key member states provide an opportunity to implement EDIS in the form of a reinsurance system that maintains national DGSs in combination with a supranational fund.

I. Introduction

As the Eurozone stands on the brink of a new pandemic-induced economic crisis, it now features a new architecture for banking supervision and resolution in the form of the European Banking Union. While the first two pillars of Banking Union, the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), were implemented rather swiftly in the aftermath of the European sovereign debt crisis considering their scope and the political controversies surrounding them, no agreement has

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been reached thus far on the third pillar of the system, the European Deposit Insurance Scheme (EDIS). Nevertheless, a coalition spearheaded by France and Italy with the support of the European Central Bank (ECB) continues to endorse EDIS, in addition adopting EDIS is also on the agenda of Commission President Ursula von der Leyen (Berschens, Greive 2019). Notably, the Association of German Banks (BdB), which represents commercial banks active in Germany, signalled its willing to compromise on the issue (Berschens 2019). Furthermore, the German Ministry of Finance (BMF) published a position paper in late 2019 that includes a design proposal for EDIS (BMF 2019). These developments point to a shift in the EDIS policy debate, with discussion moving from 'whether' to 'how' EDIS should be adopted. Hence, previous accounts addressing the failure of the initial proposal cannot remain the ultimate conclusion on the subject (Howarth, Quaglia 2015, 2016; Donnelly 2017; Mayes 2017; Ellis 2018).

To date, the EDIS policy debate has largely focused on moral hazard concerns related to uneven risk reduction across Eurozone banking sectors. Such concerns have been expressed in particular by Germany and other member states that weathered the Eurozone crisis with their banking sectors relatively intact compared to those with continuously fragile banking sectors. According these states, implementing EDIS in the face of uneven risk reduction would create moral hazard for countries with fragile banking sectors, as these countries could reap the benefits of financial stability supposedly without committing themselves to restoring their domestic banking sectors, thus simultaneously threatening the Deposit Guarantee Schemes (DGS) of other member states. In this way, the EDIS discussion has become increasingly linked to consideration of pre-emptive risk reduction deemed necessary by its opponents (Schnabel, Véron 2018). Besides shaping the political debate on EDIS, the connection to risk-reduction binds any consideration on EDIS to progress on the topics of non-performing loans (NPL) and sovereign exposure on banks' balance sheets. As a result, new EDIS drafts frequently stipulate pre-emptive risk reduction (European Parliament 2016). This also reflects in the 2016 roadmap by the Council that binds political negotiations to 'sufficient' progress on risk reduction (Council of the European Union 2016). In addition, limiting the scope of integration through EDIS has also been frequently proposed. However, alternatives to a single supranational fund have been criticized by various authors who dismiss moral hazard concerns while arguing that a reinsurance system would impair the provision of financial stability and a credible backstop (Huertas 2019; Cerrone 2018; Schoenmaker 2018; Carmassi et al. 2018, for a similar case for CMU, see Friedrich and Thiemann 2017, 2018).

However, both proponents and critics of moral hazard concerns in connection with uneven risk reduction across Eurozone tend to overlook another set of factors affecting member-state preferences and banking sector interests in relation to EDIS – namely, the preferences enshrined in the institutional structure and legal status of national DGSs, which are independent from uneven risk reduction across the Eurozone. While much of the policy debate focused on moral hazard concerns arising from uneven

risk reduction, this does not address factors connected to single national DGSs. We will show that the institutional structure and legal status of national DGSs constitute different benefits and privileges for banking sectors or certain subsector, which in turn also affected government preferences. This dynamic must be taken into account in discussions on the institutional design of EDIS, while moral hazard concerns related to uneven risk reduction are more decisive for the discussion on further risk reduction.

We limit the notion of moral hazard in this paper to concerns over uneven risk reduction across the Eurozone, as they have been most frequently voiced in that regard in the policy debate. This helps us to differentiate between moral hazard concerns related to risks on banks' balance sheets, on the one hand, and considerations on the benefits and privileges arising from national DGS arrangements, on the other. Here it should be noted that the institutional and legal set up of national DGSs and the benefits they provide for different parts of banking sectors should also be questioned, as they may create controversial economic incentives. Thus, the different preferences and positions presented in this paper should not be equated as congruous with the public interest in a given member state. Indeed, we focus solely on banking sector interests and how they influence government preferences. It is not the point of this paper to reinforce or vindicate such structures, but to highlight them as relevant factors in the policy debate that need to be critically considered.

In our view, this line of inquiry is necessary to find a politically viable solution that can act as a starting point for institution building that does not only concern national preferences but supports a more stable banking sector throughout the Eurozone. In this regard, the roadmap published by the High-Level Working Group on EDIS in December 2019 proposes a reinsurance system that combines national DGSs with a supranational fund to provide liquidity and potentially limited loss absorption (High-Level Working Group on EDIS 2019). Recent contributions by Adam et al. have elaborated on this roadmap by suggesting a potential design for a reinsurance system that also incentivizes risk reduction (2020). In order to contribute to the development of a politically viable solution for EDIS that enhances deposit insurance throughout the Eurozone, we analyse the evolution of banking sector interests connected to national DGSs and their impact on member state preferences for the institutional design of EDIS. This sheds important light on member-state preferences, thus furthering the goal of drafting a new, more realistic proposal for EDIS based on a reinsurance system that may allow the current stalemate to be broken, and, in turn, advance financial integration in the Eurozone. This being said, while a reinsurance system has the potential to amend the current system of national deposit insurance funds and reduce inconsistencies left by the 2014 Deposit Guarantee Scheme Directive (DGSD), it is not without flaws. If national DGSs are linked together in a reinsurance system, the unwarranted benefits and design flaws associated with them are likely to become more problematic. Member-state preferences to retain national DGSs should also not be mistaken as representative of the public interest. As we will

show, the benefits provided by national DGSs to banking sectors or subsectors, do not necessarily provide the best solution in terms of preventing taxpayer bailouts and ensuring financial stability.

In this paper, we trace the development of preferences on the institutional design of EDIS from 2016 onward for the cases of Germany, France, and Italy. We argue that the current set up of national DGSs in these member states have given rise to path-dependent benefits for banking sectors, and that these benefits not only shape member-state preferences in relation to a reinsurance system, but also increase the cost of adopting a full-fledged supranational fund. Path dependencies vary between member states and are most pronounced in Germany (which helps to explain the longstanding German resistance to EDIS), while they developed more recently in France and Italy. In the case of France, the banking sector lobbied to maintain the lower funding costs granted to French banks under the 2014 DGSD. In Italy, preferences are shaped by adverse experiences with resolution under the Banking Union framework and in conjunction with the limitations that would likely be imposed in connection with a supranational fund on the use of deposit insurance funds. Moreover, German cross-border active banks have also started to voice a preference for a reinsurance system. Overall, this points to the possibility of arriving at an agreement on a subsidiary reinsurance system that is linked to further risk reduction in the medium term.

Methodologically, our paper is based on an analysis of policy documents authored by banks, banking associations, central banks, and regulatory authorities. In addition, we conducted five guided expert interviews in order to supplement the information available in published documents. In terms of sampling, we cover Germany, France, and Italy, as these countries heavily influenced prior negotiations on Banking Union and EDIS (Howarth, Quaglia 2017: 5–6). Furthermore, these countries possess *de facto* veto power, as they can block any proposal in collaboration with just one other Member State (Bulmer, Paterson 2013: 1244–1263; Bulmer 2014: 1387–1405).

The paper proceeds as follows: the following sections analyse how preferences on the institutional design of EDIS developed in the three covered member states. First, we discuss the relevance of institutional protection schemes for German preference on EDIS. Second, we address the impact exerted by the legal status of the French DGSs. Third, the use of deposit insurance funds for alternative measures and the impact of the Banking Union framework are discussed for the Italian case. The final section concludes.

II. Germany and the Struggle over Institutional Protection Schemes

German preferences on EDIS are strongly connected to the distinct structure of the German banking sector. Here, the differentiation between small savings and cooperative banks, on the one hand, and large cross-border active banks, on the other, gives rise to divergent economic interests. The German

position is often explained in terms of moral hazard concerns due to uneven risk reduction, as EDIS would curtail efforts to restructure ailing banks in other member states at the expense of the more solvent German banks, who would be forced to restock depleted funds without gaining additional benefits. However, a singular focus on these moral hazard concerns fails to account for the strong preference to maintain the current institutional set up of DGSs on the side of savings and cooperative banks (Howarth, Quaglia 2017). Furthermore, preferences by cross-border active banks to implement a reinsurance system have emerged (Berschens 2019).

Focusing solely on moral hazard concerns runs the risk to represent a homogeneous stance on EDIS that does not exist, because the interests of different sub-sectors do in fact diverge. This is not to say that moral-hazard concerns are non-existent; indeed, they are clearly articulated by the National Association of German Cooperative Banks (BVR), the German Savings Banks Association (DSGV), and the Association of German Public Banks (VÖB) (VÖB 2018: 13; BVR, DSGV 2016: 1; DSGV 2018c: 1). The position advocated by savings and cooperative banks is generally connected to path-dependent benefits that arise from the institutional protection schemes they run, which are registered as a DGS but provide comprehensive mutual support beyond mere deposit insurance. Specifically, the DGS safeguards the solvency of participating institutes through supervision and emergency support, thus helping to prevent insolvency. The deposit insurance function only applies when an institute defaults despite the institutional protection scheme, an event that is to be prevented at all costs. While this mutual support function prevents the closing of struggling institutes, some actors have questioned the suitability of these arrangements, including the ECB, which has been analysing the recapitalization of Landesbank Nord LB. The decision-making structures of the institutional protection scheme have come under particular scrutiny. Nord LB, like other Landesbanken, is covered by the institutional protection scheme of savings banks. Notably, ECB concerns are shared by BaFin, Germany's national competent authority (NCA), as BaFin and the ECB recently published a joint letter critically analysing savings banks' institutional protection scheme (Frühauf 2020). An additional point of contention is whether the scheme is compatible with the concept of market discipline as envisioned by the Banking Union framework.

A supranational EDIS that would supersede institutional protection schemes is a concern for Germany's savings and cooperative banks, since these schemes are seen as the element connecting the participating institutes, which are legally separate but utilize a shared brand. Savings and cooperative banks argue that most customers are likely unaware of this *de facto* separation under a shared brand; thus, a defaulting institute would potentially harm the whole group. In this way, the institutional protection scheme can be viewed as a path-dependent benefit that safeguard continuous customer business, instead of a pay-out in the case of default (Interview 5 9/27/2018). Moving to a fully supranational EDIS

would disrupt current benefits, because the control over insurance funds would be moved to the supranational level, restricting the ability of the subsector to prevent defaults (BVR 2017: 1; DSGV 2018a: 8, 2018c; VÖB 2018: 13). Here, a reinsurance system based on liquidity provisioning is a potential solution to this problem; however, these institutes remain highly critical of this proposal, for they see it as a stepping stone to a fully supranational EDIS (DSGV 2018b: 13; VÖB 2018: 13).

Conversely, a fully supranational EDIS would reduce costs for cross-border active institutes, which do not run institutional protection schemes but rather a regular DGS limited to deposit insurance (Interview 1 8/14/2018; Interview 2 8/16/2018). Cross-border active banks would also benefit from decreased compliance costs, giving them a competitive edge over their domestic counterparts, which would not have lower compliance costs through EDIS (Interview 1 8/14/2018; Interview 3 8/27/2018; Interview 4 8/31/2018). As the largest representative of the commercial subsector, Deutsche Bank is not strictly opposed to EDIS, referring to it as viable in principle (2017c: 5–6). However, Deutsche Bank has placed a similar emphasis on the necessity for risk reduction in numerous Eurozone banking sectors (2017a: 3–4, 2017b: 13, 2017c: 5–6) reflecting moral-hazard concerns. Despite these potential benefits, the BdB, which represents commercial banks active in Germany, long withheld explicit support for a full-fledged EDIS. However, the BdB recently signalled its willingness to accept a reinsurance system, if coupled to risk reduction (Berschens 2019). This shift reflects the increasing interest of cross-border active banks to progress financial integration rather than prolong protection for domestic banks, as such protection particularly benefits domestic institutes (Culpepper, Tesche 2019).

The diverging interests within the German banking sector demonstrate that there is not a uniform corporate interest that could be represented by the government, as has been implied in the discussion on moral hazard. While the demand for pre-emptive risk reduction is shared across the German banking sector and also reflects in the position of the BMF (BMF 2019; Scholz 2018), there is no uniform stance on the future institutional design of deposit insurance. Rather, preferences diverge between savings and cooperative banks' support for national DGSs without integration, on the one hand, and cross-border active commercial banks' support for a liquidity-based reinsurance system, on the other. Until recently, commercial banks did not push for EDIS at the association level, thus providing tacit support for the anti-EDIS stance of savings and cooperative banks. In addition, savings and cooperative banks do retain a particularly strong lobbying position, as most are chaired by elected politicians, most state-level politicians being involved in savings banks, and due to their role in financing the German Mittelstand (Markgraf, Véron 2018; Interview 4 8/31/2018; Interview 5 9/27/2018). Hence, preference formation in Germany has been predominantly driven by the economic interests of savings and cooperative banks, which is reflected in the long-running opposition of the BMF and Bundesbank to the adoption of EDIS in the foreseeable future; however, they do not rule out EDIS in principle (Scholz 2018; Dombret 2018a, 2018b; Weidmann 2018).

In late 2019, the BMF, under social-democrat Olaf Scholz published a position paper on the goals of the Banking Union, which for the first time included an explicit proposal on the institutional design of EDIS. This was after the BdB signalled its willingness to support a reinsurance system coupled to risk reduction, thus spelling out the divergent interests of the German banking sector. The BMF paper concludes that after further substantial risk reduction, including a range of ambitious topics beyond NPLs[1], EDIS could be introduced in the form of a reinsurance system that would amend national DGSs with a supranational fund providing loans to DGSs, should these be depleted. In addition, EDIS would provide a limited form of loss absorption (BMF 2019: 6). The continuous demand for further risk reduction on the side of the German government clearly reflects the common interests for risk reduction on the part of the German banking sector; meanwhile, the BMF's apparent acceptance of a reinsurance system contradicts the anti-EDIS stance of savings and cooperative banks. However, a reinsurance system coupled to substantive risk reduction that also maintains national DGSs is currently the only intersection of savings and cooperative banks' preferences and the preferences of cross-border active commercial banks, on the other. Nevertheless, it is still an open question as to whether the German government will ultimately commit to a reinsurance system, because the BMF paper was not developed in collaboration with the conservative parts of the coalition, particularly Chancellor Angela Merkel. The proposal should be interpreted in the context of bargaining on the conditions connected to EDIS, as it outlines a comprehensive list of necessary risk reduction measures. Various elements, including the demand to regulate bank exposure to sovereign debt, introduced further conflict to the policy debate, thus thwarting a consensus on a roadmap for EDIS in December 2019 (Fleming, Johnson 2019).

III. France – Special Benefits for a Concentrated Banking Sector

The French banking sector offers a very different picture when compared to its German counterpart, primarily because it is dominated by a small number of large, cross-border active banks. Under France's universal banking model, banks offer a broad range of services under one roof, which has led (among other factors) to a highly concentrated sector (Thiemann and Lepoutre 2017). These large cross-border active banks have the biggest influence on French EDIS preferences, as there is no other significant subsector that could outmatch their influence or resources. Their preferences are largely aligned with those of other cross-border active banks throughout the Eurozone, but they are also shaped by the legal status of the French guarantee scheme.

[1] In terms of risk reduction necessary before implementing EDIS, the position paper lists more consistent and effective supervision of banks, harmonization of bank insolvency legislation, further development of a European resolution regime, deeper integration of cross-border banking groups, reduction of NPLs, and (most controversially) adequate regulation of sovereign bonds.

While the major French banks are similar to the German counterparts in terms of size and cross-border activities, they generally are in a much stronger economic position (Interview 1 8/14/2018). Nevertheless, low NPL ratios in both the German and French banking sector align their position concerning demands for risk reduction prior to the implementation of any shared deposit insurance system (Interview 4 8/31/2018). Such risk reduction has been explicitly advocated by the French Banking Federation (FBF) (2017a, 2017b, 2018). Moreover, a fully supranational EDIS would not pose a fundamental challenge to the institutional setup, as it would for German savings and cooperative banks. In fact, like their German counterparts, cross-border active French banks could benefit from a fully supranational EDIS due to a lowering of compliance costs (Interview 1 8/14/2018).

However, French banks began to advocate a different position after the implementation of the 2014 Deposit Guarantee Scheme Directive (DGSD), which grants a lower target level for highly concentrated banking sectors such as the French one. This provision aims to account for the ostensibly lower likelihood that a higher target level becomes necessary in these banking sectors, as they consist of large banks that would be resolved under the SRM using funding from the Single Resolution Fund. Accordingly, French banks benefit from lower contributions compared to banks in other countries. This represents a major lobbying success that will not be given up easily (Interview 3 8/27/2018; Interview 4 8/31/2018; Interview 5 9/27/2018). While the economic viability of this position is strongly disputed, it nevertheless provides the basis for a preference to retain the rules of the current DGSD. Accordingly, the FBF recommends 'a reinsurance system in which national deposit insurance funds can be maintained' (2017a) including an exemption for the French banking sector. The FBF has also actively lobbied for a change in the government's position, as reported in a 2016 article in the German business daily *Handelsblatt* citing an FBF letter in which its president distances himself from a fully supranational fund and instead proposes a reinsurance scheme (Berschens 2016).

Indeed, the stances taken by the French Prudential Supervision and Resolution Authority (ACPR), and by François Villeroy de Galhau, the president of the Banque de France, have both moved closer to the banking-sector position by advocating a reinsurance system (ACPR 2016; Villeroy de Galhaul 2017, 2018). Both positions are not equivalent to the position of the French government, which has been a longstanding supporter of a full-fledged EDIS (Interview 5 9/27/2018), despite a lack of explicitness on this issue in recent statements. Nevertheless, the fact that the ACPR and the Banque de France have changed their positions shows that public bodies have been influenced by the current legal status of the national DGS. Certainly, the pressure on the French government to support the position of the banking sector has increased (Interview 5 9/27/2018). In conclusion, the French banking sector's preference for a reinsurance system, which would safeguard the lower target level granted to it, underlines the analytical importance of considering national DGSs for considerations on the institutional design of EDIS. In this regard, a one-sided focus on the more prominently discussed aspect of risk reduction

would fail to apprehend the nature and source of domestic banking sector interests. The extent to which these interests will actually translate into government preferences in future negotiations remains to be seen. In this regard, it should be considered that lower DGS funding can hardly be in the interest of the French government, as this could culminate in taxpayer-funded bailouts. This again shows that banking sector interests are not equivalent to the public interest, particularly when it comes to DGS funding, but they are still a relevant factor that needs to be understood to grasp the motivations underlying the policy debate.

IV. Italy – The Case of alternative Measures

Preference formation in Italy, both public and private, is driven by the continued vulnerability of the Italian banking sector to the sovereign–bank nexus. However, the position of Italian banks evolved in conjunction with experiences under the Banking Union framework and legal disputes with the Commission over the use of deposit insurance funds for alternatives measures. These latter factors must be considered when addressing the challenges faced by the Italian banking sector. Italy's banking sector has a comparatively high number of banks, but, in contrast to Germany, small savings and cooperative banks are less dominant; furthermore, consolidation continues, particularly among cooperative banks (Bülbül et al. 2013: 3–4; Quaglia 2014: 223; Bilotta 2017, Thiemann 2018). NPL ratios are still comparatively high with respect to historical averages, although they have been considerably reduced since 2016 (European Banking Authority 2019),[2] and the banking sector features large sovereign exposure, making it particularly vulnerable to the sovereign–bank nexus (Gros 2019). Accordingly, Italian banks and authorities have been consistent in their support for EDIS, as it has been seen as a way to break the sovereign–bank nexus (ABI 2016, 2017: 3–4; Visco 2018; Presidenza del Consiglio dei Ministri 2018: 9–10; Panetta 2018b: 8–9; MEF 2019: 78). Contrary to its northern counterparts, the Italian Banking Association (ABI) argues that risk reduction has been sufficient (ABI 2016, 2017: 3–4) and that EDIS in itself would contribute to risk reduction via risk sharing, a stance that is supported by the Bank of Italy and the Ministry of Economy and Finance (MEF) (MEF 2016: 4–5; Polis 2016: 13; Bank of Italy 2018: 14–16).

Beyond the issue of risk reduction, the Italian use of national DGS for alternative measures aside from depositor pay-out is a crucial factor for understanding the Italian stance on the institutional design of EDIS. What distinguishes Italian guarantee schemes is their emphasis on alternative measures in addition to deposit insurance, which aim to prevent bank failure instead of providing pay-outs. This DGS

[2] Most recent data from the European Banking Authority are for Q3 2019 and do not account for the impact of the COVID-19 pandemic, which is likely to increase NPL numbers.

function represents a path-dependent benefit for the banking sector, which are connected to the current configuration of national DGSs. These benefits apply particularly to cooperative banks, which have particularly benefited from the use of alternative measures during the banking sector consolidation of recent years. While a fully supranational EDIS based on loss absorption instead of liquidity would be arguably more effective at breaking the sovereign–bank nexus, this would also shift decision-making power over the use of alternative measures to the supranational level (most likely to the Commission and/or the Council, as is the case for the Single Resolution Fund). If this would imply ruling out alternative measures, it is assessed as a substantially negative outcome by Italian authorities (Polis 2016: 15; Visco 2017: 10; Panetta 2018a: 9–11) and run contrary to the interests of Italian banks (Interview 5 9/27/2018).

Since the inception of Banking Union, various episodes have taken place that have affected the assessment of the Italian banking sector and government regarding the possibility of using deposit insurance funds for alternative measures under a fully-fledged EDIS. One key event was the bailout of two cooperative banks in 2017; where only a last-minute re-evaluation by the Single Resolution Board and Commission paved the way for the state bail-out preferred by the Italian government. This made the Italian government concerned that a supranational authority overseeing deposit insurance would likely be opposed to the Italian preference to use deposit insurance funds for alternative measures such as bank recapitalization (Interview 5 9/27/2018). Italian preferences in this regard are further underscored by the December 2019 bailout of Banco Populare di Bari; the DGS was used to recapitalize an ailing bank, instead of depositors pay-out (Krieger 2019). Moreover, in 2014 the Commission considered measures taken by an Italian DGS in support of Banca Popolare di Bari during its acquisition of a small regional bank to be an instance of state aid. These measures were endorsed by the Bank of Italy, which further demonstrates the divergence between the Commission and Italian authorities when it comes to assessing alternative DGS measures (Bank of Italy 2019). With a view to banking sector preferences, the Italian association of cooperative banks (BCC), which runs institutional protection schemes similar to their German counterparts, has also argued strongly for a version of EDIS that retains national DGSs (BCC 2016: 6–7). Overall, the Italian stance of using DGS funds for alternative measures, including recapitalization, is not consistent with the idea of market discipline enshrined in the Banking Union, because it is opposed to the Banking Union resolution framework. However, these recapitalization decisions were motivated in part by electoral concerns, as they impacted local savers (Donnelly, Asimakopoulos 2019).

In this way, while concerns regarding the sovereign–bank nexus still constitutes a strong reason for the Italian EDIS preferences, this support is tempered by likely limitations to the use of deposit insurance funds for alternative measures. Indeed, the interest to retain national DGSs, which is particularly pronounced among Italian cooperative banks, is important for understanding Italian EDIS preferences. The

Italian government has not made recent statements regarding its specific preferences for the design of EDIS; rather, it has only voiced general support for EDIS. However, we should expect scepticism engendered by past clashes with the Commission to impact Italian considerations regarding the design of a supranational deposit insurance scheme. In this regard, Italy's preferences have moved toward a subsidiary form of EDIS, such as a reinsurance system that maintains national DGSs and thus national decision-making over the use deposit insurance funds. Here, again, a sole focus on risk reduction and the fallout emanating from the sovereign–bank nexus fails to account for the Italian preference to retain decision-making authority over deposit insurance funds.

Table 1. Comparison of Banking Sector Structure, National DGSs, and Banking Sector Preferences on EDIS

Member State	Banking Sector Structure	Banking Sector Condition	DGS Specifics	Banking Sector Preference
Germany	Differentiated between domestic banks and a few cross-border active banks	Low NPL level	DGSs function as institutional protection schemes for savings and co-operative banks	Either no EDIS, or reinsurance system with risk-reduction conditionality
France	Dominated by cross-border active banks	Low NPL level	Exemption on target level (0.5% instead 0.8%)	Reinsurance system with risk-reduction conditionality
Italy	Differentiated between domestic banks and cross-border active banks; ongoing consolidation	High NPL level; large sovereign exposure	Usage of DGS funds for alternative measures (recapitalization)	Reinsurance system without risk-reduction conditionality

Source: Own creation.

V. Conclusion

In this paper, we argued that member states' preferences on the institutional design of EDIS in Germany, France, and Italy should not be understood solely based on moral hazard concerns over uneven risk reduction across the Eurozone, but also in relation to path-dependent factors arising from the specific set-up of national DGSs. Accordingly, any attempt to revitalize the stagnant policy debate on

EDIS must give due consideration to the preferences that prevail in individual member states regarding national DGSs, preferences that typically emanate from banking-sector interests. A policy debate that focuses solely on moral hazard concerns over uneven risk reduction might, on the upside, be capable of generating further risk-reduction measures, but it is less likely to advance the debate in terms of developing a politically viable institutional structure for EDIS. While member states' preferences concerning their national DGSs should not be understood as a blueprint that deterministically defines the outcome of policy debate, they need to be considered. Otherwise, it is unlikely that a breakthrough in negotiations can be achieved, even given a consensus on further risk reduction might be accomplished.

With a view to member-state preferences on the institutional design of EDIS, we demonstrated a degree of alignment between the three covered countries, although strong divergence persists concerning pre-emptive risk-reduction. In Germany, savings and cooperative banks continue to oppose a full-fledged EDIS in order to preserve their institutional protection schemes. German cross-border active commercial banks have also started to show greater receptiveness to a reinsurance system that is coupled to additional risk reduction; such a solution has been advocated by the BMF, among others. The French banking sector, for its part, has pressed for a reinsurance system that maintains national DGSs, in order to retain the lower target level and associated lower costs for French banks. In Italy, by contrast, adverse experiences with the transfer of decision-making competence over bank resolution and clashes with the Commission over the use of deposit insurance funds for alternative measures have dampened enthusiasm for shifting further decision-making powers to the supranational level.

Overall, this complicates the situation for actors advocating a full-fledged EDIS, such as the Commission and ECB, who prefer a more integrated EDIS over continued national schemes. Our findings should not be misunderstood as an economic assessment of the viability of a fully supranational fund. Rather, given current political trajectories, implementing a fully supranational fund has simply moved further out of reach, despite progress in the area of risk reduction. Nevertheless, we show that the current political trajectories hold the potential for adopting EDIS in the form of a reinsurance system that maintains national DGSs by linking them in a network that includes a joint supranational fund. While adopting such a solution would be contingent on agreement concerning the scope of further risk reduction, developments in Italy, France, and, to a more limited extent, Germany do provide a way forward in the policy debate on EDIS. To be sure, a reinsurance system that links national DGSs would represent an incremental reform step, but it would abide to the principle of subsidiarity and is politically more viable.

A final point should be considered: DGSs are invariably political institutions; first of all, in the sense that they rely on implicit state guarantees to provide a credible backstop in case of a severe banking crisis, as they their funding is always restricted to a small proportion of the actual insured deposits.

And second, in the sense that their specific set-up is bound to political considerations native to national banking sectors. In the case of Germany, the cooperative and particularly savings banks from a key player in financing of the German *Mittelstand*; hence their institutional protection schemes are also bound to political interests. In France, the lower target level granted to the French DGS is a political achievement that supports French banks. And in Italy, the use of deposit insurance funds to recapitalize cooperative banks and to support takeovers between Italian cooperative banks is bound to political considerations over the future of Italy's banking sector, not to mention electoral concerns. While these factors are often overlooked in discussions concerning risk reduction measures, progress in the EDIS debate necessitates a broader assessment that takes political preferences on national DGSs into account.

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