

DEVELOPMENT OF THE EUROPEAN BANKING UNION AND BARRIERS TO ITS COMPLETION: A BRIEF REVIEW

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Abstract

The European Banking Union aims to integrate and stabilize European banking systems, yet it remains incomplete nearly two decades after the 2008 crisis. This paper reviews key legislative milestones and synthesizes the academic literature on the development of the Banking Union. The literature identifies the absence of a European Deposit Insurance Scheme as the central missing pillar. The core obstacle is a distributive conflict over risk sharing: Germany and allied creditor states prioritize risk reduction, while several Southern member states favour risk sharing. EU-level negotiations, therefore, continue to centre on identifying politically feasible compromises between risk reduction and risk sharing. Recent progress is reflected in advancing talks on the Crisis Management and Deposit Insurance reform package. The article provides a political economy–informed synthesis of the dynamics that have delayed completion. It focuses on national preferences, institutional constraints, and recent policy sequencing.

Keywords: Banking Union, European Union, policy-making, regulatory framework, Banks, Legislation
JEL Classification: E44, E58, G28, K2,

Introduction

The European Banking Union (EBU) is a landmark in the evolution of European financial integration, created in response to the vulnerabilities revealed by the 2008 financial crisis. From the earliest days of European integration, policymakers sought to harmonize banking systems, but the crisis exposed how nationally fragmented regulation and supervision could amplify systemic risks. In its aftermath, the EU pursued a new framework to strengthen financial stability through common supervision, resolution mechanisms, and harmonized deposit protection.

The EBU's architecture consists of three pillars: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM), and the European Deposit Insurance Scheme (EDIS) (Howarth and Quaglia, 2013). While the first two pillars are operational, the EDIS remains incomplete due to persistent political disagreements, making it the focus of current debates about the EBU's future (Donnelly, 2018). The absence of the EDIS remains a central sticking point, as member states struggle to find common ground on how risks should be shared or reduced across the Union.

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Existing literature identifies the EBU's primary objectives: safeguarding financial stability and improving microeconomic efficiency. However, achieving these goals has been complicated by tensions between core and peripheral member states, differences in national banking structures, and divergent preferences over risk sharing versus risk reduction under the European Central Bank (ECB)-centred supervision (Howarth and Quaglia, 2018; Quaglia, 2019). The European decision-making structures involve complex negotiations among member states, the European Commission, and the European Central Bank. This process has often resulted in compromises that soften proposals for more profound integration (Braun et al., 2018; Högenauer, 2023).

This paper examines the development of the EBU, focusing on political economy factors shaping its incomplete institutional architecture. While the EBU has been widely studied, most research focuses either on its legislative evolution or on the political economy of individual pillars. Few works combine these perspectives with an analysis of the post-COVID context. The paper contributes by offering an integrated and up-to-date synthesis of legislative developments and national bargaining positions, with particular attention to post-COVID sequencing.

Methodologically, the article combines peer-reviewed research with EU legislation and official institutional communications. It examines why the EBU remains institutionally incomplete, with particular attention to EDIS. The analysis maps key legislative milestones and synthesizes political economy research on the incomplete EBU. It identifies key institutional, political, and economic factors behind the persistent fragmentation of the EBU.

1. Objectives and Logic of the European Banking Union

The EBU's creation was driven by political necessity and institutional learning from the failures during the 2008 financial crisis. In particular, the crisis showed that banking systems managed solely at the national level were ill-prepared to deal with cross-border financial contagion. Fragmented regulation and weak coordination among national supervisors deepened the crisis and revealed the structural limitations of the existing system. One of the key problems was that fragmentation led to uneven national responses, undermined monetary policy transmission, and limited the EU's ability to respond in a unified way. The crisis highlighted the need for a more centralized and supranational approach to banking supervision and crisis management. As a result, political momentum gathered around the idea of creating a banking union, based on the logic that shared supervision would prevent regulatory arbitrage and help to break the vicious circle between banks and sovereign debtors. National regulators, while retaining exclusive authority over domestic policies, in some cases tended to prioritize the interests of domestic banks over those of foreign-owned institutions. Following the onset of the crisis, this preference for national-owned entities led to weaker cooperation among national supervisors (Epstein and Rhodes, 2016; Kudrna and Gabor, 2013). Heterogeneous national banking models and supervisory practices contributed to uneven crisis outcomes across

member states; for example, Spain's bank-financed real estate boom contrasted with Italy's more conservative lending structure, which reinforced fragmentation and cross-border spillovers (Quaglia and Royo, 2015).

As stated previously, the decision to grant binding regulatory powers to a supranational authority, specifically the European Banking Authority (EBA), tasked with introducing the Single Rulebook, marked a substantial step toward deeper integration. Other essential steps involved the implementation of Basel III rules through EU legislation and redistributing supervisory competencies between national regulators and a centralized EU-level actor. These changes represented one of the most significant evolutions in supervisory coordination across the Union. The shift towards supranational supervision became fully visible with the SSM launch, which formed one of the three main pillars of the EBU. Under the SSM framework, the ECB was given formal authority over the supervision of significant financial institutions, making it the key player in the EU's financial oversight architecture (Pánek, 2013; Spendzharova, 2014).

The SSM represents the first and most institutionalized component of the EBU project. The EBU characterizes a project that aims to strengthen banking supervision, enforce capital rules, and avoid bailouts of banking institutions. The SSM operates as a supranational centralized system with the ECB at the top, with significant power over national authorities.

Its effectiveness relies on cooperation between the ECB and national competent authorities, coordinated through Joint Supervisory Teams (JSTs) that combine local expertise with EU-level oversight. Supervisory rules and methodologies are subject to continuous adaptation, based on practical experience and evolving risk assessments (Gutiérrez-López and Abad-González, 2020; Zeitlin, 2023).

The EBU illustrates a structural asymmetry between negative integration, which is understood as the technocratic harmonization of prudential rules through the SSM, and positive integration, which would require sustained political consensus on fiscal risk-sharing through a common deposit insurance framework. While the former has been successfully institutionalized, the latter remains unresolved. The prolonged impasse surrounding the European Deposit Insurance Scheme (EDIS) reflects less a set of outstanding technical preconditions than a persistent political economy tension between creditor and debtor member states. Creditor countries, most notably Germany, had conditioned further mutualization on continued progress in risk-reduction indicators, while debtor countries faced adjustment requirements that are politically and economically difficult to sustain within a monetary union lacking a fully developed fiscal capacity. This asymmetry helps explain both the sequencing of reforms within the EBU and the preference for incremental institutional adjustments over full-scale fiscal mutualization (Höpner et al., 2025; Pérez, 2019; Schild, 2018).

2. Historical Evolution and Legislative Milestones

Before 2008, European banking integration advanced mainly through incremental harmonization of market-access and prudential rules, while supervision and crisis management remained largely national. This institutional fragmentation left the EU with limited capacity to address cross-border banking distress, a weakness exposed by the global financial crisis and later by the euro-area crisis (Posner and Véron, 2010).

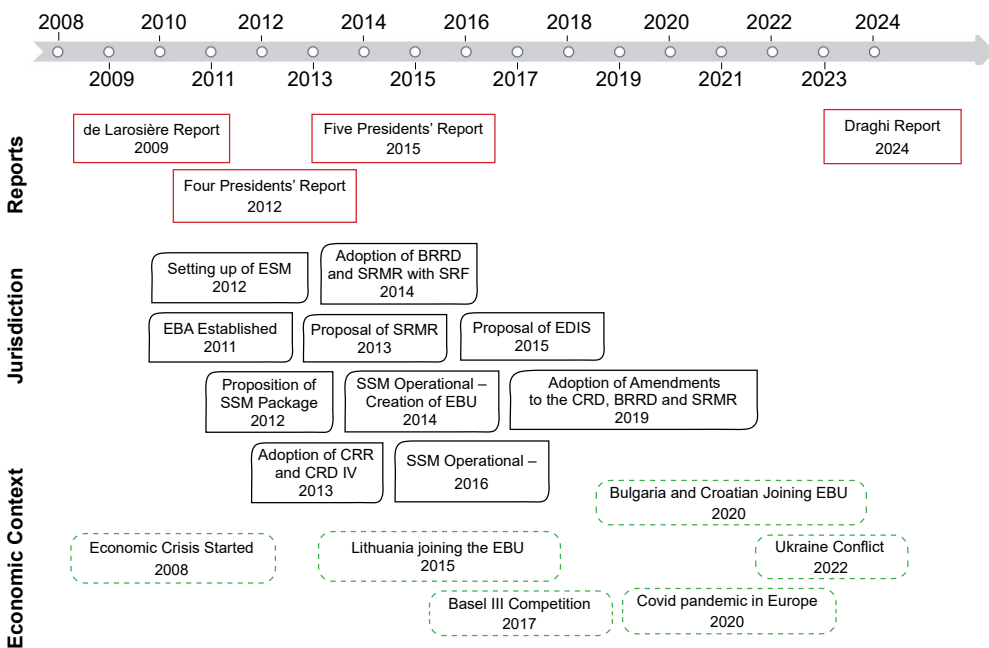
Post-2008 development of banking integration

The vulnerabilities in the European banking sector during the 2008 crisis underscored the need for structural reform in which public funds would no longer be used to bail out failing banks. Instead, a “bail-in” approach would be applied, requiring creditors and shareholders to absorb losses to protect public finances. This bail-in system was formally established in EU law in 2014. However, the De Larosière Report (2009) had already set its conceptual foundation, which proposed a new structural framework for the European financial system. The Report identified global macroeconomic imbalances, excessive liquidity, and weak monetary policy as contributors to the economic crisis. It also mentioned the role of extensive risk acceptance, leverage, and complex financial instruments as amplifiers of the crisis.

Furthermore, ineffective corporate governance, inadequate regulatory oversight, and weak risk management practices facilitated the spread of financial instability. The Report’s recommendations led to the design of a new framework to safeguard financial stability. At the macroprudential level, this included the creation of the European Systemic Risk Board (ESRB), and at the microprudential level, the establishment of the European System of Financial Supervision (ESFS), which comprises the EBA, the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA) (de Larosière, 2009). The EBA was formally established under the Regulation (EU) No 1093/2010. Figure 1 illustrates the key steps leading to harmonizing banking regulations.

The creation of the EBU is generally dated to 2014 when the SSM became operational. The second pillar, the SRM, was launched in 2016, while the third pillar, the EDIS, has not yet been established. The SRM emerged from intergovernmental discussions and compromises, with Germany playing a central role. EU institutions worked in an interdependent manner to advance the EBU, with the establishment of the SSM requiring close cooperation between the ECB and the European Commission (Nielsen and Smeets, 2018). Numerous scholars have emphasized that the absence of the EDIS remains the key shortcoming of the EBU (Donnelly, 2018; Howarth and Quaglia, 2018; Kudrna, 2016).

Figure 1: Chronology of the Banking Union development



Source - Author's elaboration based on relevant EU legislation

Single Supervisory Mechanism

The Council Regulation (EU) No 1024/2013 established the SSM, which granted the ECB responsibility for supervising significant banks and thereby created a consistent supervisory mechanism. This act was complemented by Regulation (EU) No 468/2014, which defines the operational specifics of cooperation between national supervisory authorities and the ECB (Council Regulation (EU) No 1024/2013, 2013).

Single Resolution Mechanism

The Directive 2014/59/EU, known as the Bank Recovery and Resolution Directive (BRRD), established common standards for banking resolutions. One of the main objectives was to introduce a bail-in model, under which taxpayers' money would not be used to save banks. Instead, losses would be imposed on shareholders and creditors (Directive 2014/59/EU, 2014). The SRM, which includes the Single Resolution Fund (SRF), was defined in the Regulation (EU) No 806/2014, complementing BRRD (Barata, 2022; Regulation (EU) No 806/2014, 2014).

European Deposit Insurance Scheme

The EDIS constitutes the most politically contested pillar of the EBU and remains under discussion. Since the European Commission presented its proposal in 2015, several negotiation rounds have taken place, but no viable legislative compromise has emerged. The proposal followed a phased approach, starting with reinsurance and moving toward higher levels of mutualization. In the policy debate, the deadlock over EDIS reflects a persistent political cleavage between creditor and debtor member states rather than unresolved technical design issues. Creditor countries, most notably Germany and other northern euro-area members, have consistently opposed deeper mutualization on moral-hazard grounds, arguing that extensive risk sharing could weaken incentives for national risk reduction in fragile banking systems. This logic has been reflected in the European Commission's phased proposal, in which the reinsurance stage deliberately preserves national responsibility and accountability during the transition. By contrast, debtor countries and the ECB emphasize the stabilization benefits of risk sharing, arguing that a more mutualized EDIS would contribute to risk reduction by improving diversification and weakening the sovereign–bank nexus. Some ECB-affiliated analyses suggest that a common deposit insurance fund would not generate systematic unwarranted cross-subsidization across banking systems, thereby challenging core creditor-state concerns (Carmassi et al., 2018; European Commission, 2016; Hallak, 2024; Wolff, 2016).

Progress has been blocked by unresolved disputes over risk mutualization, national sovereignty, and the heterogeneity of existing deposit guarantee systems. In the Council, further movement has been linked to additional risk-reduction measures in euro-area banking sectors, reinforcing a sequencing logic that has proven difficult to overcome. Peripheral euro-area countries and EU institutions have framed EDIS as necessary to complete the EBU and weaken the sovereign–bank nexus, whereas fiscally stronger member states, most notably Germany, invoke moral-hazard concerns (Centre for European Policy (CEP), 2016; ESM, 2026; European Parliament, 2024; Howarth and Quaglia, 2018; Kuznichenko et al., 2021).

Complementary Regulatory Measures - Basel III Implementation

In parallel, the Basel III standards were incorporated into EU legislation as complementary measures to the EBU. The Basel Committee on Banking Supervision published a set of measures called Basel III. Following Basel I and II, these reforms introduced requirements in areas such as capital adequacy, leverage ratios, and liquidity standards. The quantitative elements were implemented through the Capital Requirements Regulation (CRR), while qualitative elements were incorporated into the Capital Requirements Directive (CRD). The CRR and CRD are complementary measures under the EU's single rulebook.

The CRR and CRD harmonize prudential rules across member states but are not considered core pillars of the EBU (Hartmann-Wendels, 2013).³

3. Diverging National Preferences and the Political Economy of EDIS

Building on this cleavage, the following section details how national banking structures and domestic political coalitions shape member-state preferences over EDIS and related integration measures. It shows how these domestic configurations translate into stable negotiation positions at the EU level, thereby constraining the scope and sequencing of further EBU reforms.

Fragmentation of National Positions

Instances of regulatory divergence emerged during the implementation of harmonized EU requirements, implying that national understandings continued to play a role. Some member states preferred varying degrees of implementation strictness due to differences in their banking systems. Germany opposed tighter capital requirements, as large cooperative and mutual banks relied on state-backed funding. France negotiated in favour of its banks with insurance subsidiaries, arguing that banning double-counting capital would undermine their competitiveness. The UK supported stricter capital requirements because its banks generally maintained stronger equity positions (Howarth and Quaglia, 2013). Diverging national positions also influenced the banking resolution process. Influenced by German and French positions, particularly Germany's preference for stricter bail-in rules, the Single Resolution Board (SRB) has often favoured liquidation over resolution, based on a narrow interpretation of the public interest (Asimakopoulou and Howarth, 2022).

Political Negotiations and the Incomplete Banking Union

The behaviour and positions of national governments during the creation of the EBU have become an important area of academic research. During post-crisis negotiations, national governments transferred part of their sovereignty to the EU and the European Commission, while the ECB gained greater importance in banking regulation. Germany served as the main political opposition to centralized proposals, though it partially accepted centralization in the final

3 **CRD and CRR legislation** - The CRD IV defines prudential requirements for credit institutions and investment firms, including provisions on authorization, minimum capital, liquidity, risk management, remuneration, and bank resolution. To further implement Basel III measures, the CRD V Directive (EU) 2019/878, amending the CRD IV Directive, was passed in 2019 (Directive 2013/36/EU, 2013). The CRR focuses on strengthening banks' loss-absorbing capacity and disclosure requirements. In 2019, the CRR II Regulation (EU) 2019/876 introduced additional Basel III provisions (Regulation (EU) No 575/2013, 2013). Together, the CRD and CRR anchored the countercyclical capital buffer into EU law as a macroprudential tool. This buffer requires banks to build up capital during economic expansion, ensuring sufficient reserves in downturns. It serves as a preventive measure to mitigate the impact of future financial crises (ESRB, 2024). These legislative milestones set the stage for the political bargaining that has since shaped the incomplete architecture of the EBU.

framework. The European Commission's proposals reflected the diversity of member states' positions, thereby reducing Germany's relative influence during negotiations. The urgency to break the sovereign-bank doom loop, a self-reinforcing cycle in which a state's financial troubles weaken domestic banks holding its debt, while struggling banks in turn increase the state's fiscal burden through potential bailouts, pushed governments to accept supranational authority. As a result, they agreed to harmonization through the EBU. Italy, France, and EU institutions supported a fully completed EBU, while Germany preferred a limited version with reduced risk-sharing and constrained supranational control. Consequently, the SSM granted the ECB authority over significant banks, the SRM was focused primarily on cross-border banks, and the EDIS remained unfinished (Epstein and Rhodes, 2016; Skuodis, 2018).

Academic Perspectives and Prevailing Views

Scholars note that disputes among member states persist, momentum for completing the EBU has slowed, and the project remains unfinished. As pointed out, fragmentation makes it harder for EU banks to compete globally. It also slows down joint responses when quick, coordinated action is needed. Completing the EBU is moreover seen as essential for Europe's microeconomic and macroeconomic strength. At the micro level, it could operate more effectively, raise its profitability thanks to scale effects, and better face up to foreign competition. At the macro level, an accurate, completed single banking market would serve as a subject of strategic autonomy for the EU (Villeroy de Galhau, 2021).

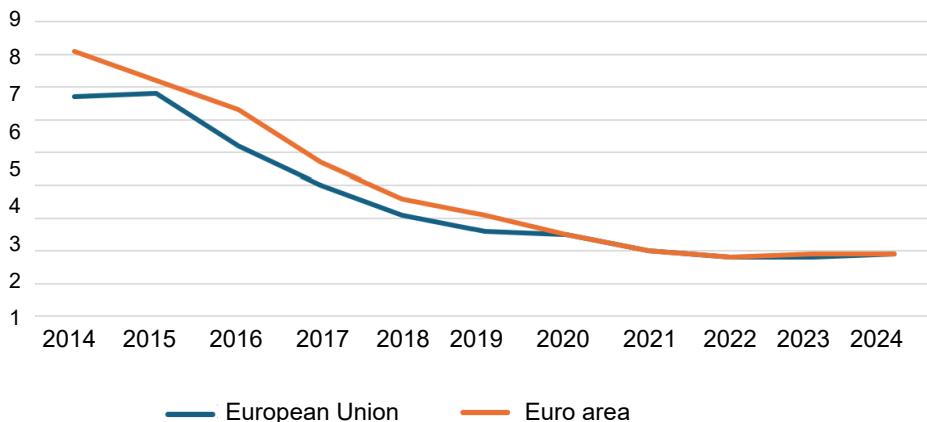
German opposition to the EDIS has been rooted in fears of moral hazard, with concerns that its well-funded deposit scheme would disproportionately support schemes in other member states with less stable banking systems. The fragmentation of deposit insurance schemes reflects diverse banking structures across the EU. Consequently, countries with stable schemes, such as Germany, the Netherlands, Austria, and Finland, oppose unification and advocate for risk reduction through higher capital standards and stricter supervision, in order to minimize costs and moral hazard (Donnelly, 2018; Howarth and Quaglia, 2018).

Country Positions

Germany - The German government opposed the EDIS largely because non-performing loans were concentrated in southern euro area countries. The Ministry of Finance feared that creating a common fund would reduce incentives for southern European banks to restructure their portfolios. Germany argued that, among others, the non-performing loans (NPL) ratio should first fall significantly below 2% of total loans. Additional concerns include the high concentration of domestic government bonds in local banks, which currently do not require extra capital reserves. Sovereign risk must be reduced in the balance sheets of banks, as well as progress in harmonization in other policy integration areas, such as insolvency. Potential fiscal problems, Germans warned, could spread financial liabilities across all EDIS members (Dombret, 2015; Płóciennik, 2018).

Figure 2 shows that in the initial stages of the EBU, NPL represented a significantly larger share of total loans. The euro area's aggregate NPL ratio declined steadily but did not fall below 3% until 2020.

Figure 2: Gross non-performing loans (% of total amount)



Source - Author's elaboration based on (Eurostat, 2025)

France - The French government advocated for a deeper EBU. In 2017, the President called for the creation of a common Ministry of Finance for euro area countries, with a separate budget for its members. Unlike Germany's fragmented banking sector, which is dominated by local Sparkassen, France's largest banking groups operate extensively across the euro area and rank among the largest banks in the region by total assets (Euroactiv, 2017; Mones et al., 2025; Mones and Hayes, 2024).

Southern Europe – Drawing on their experiences from the 2008 financial crisis, Portugal and Spain have consistently supported completing the EBU. Ireland and Spain illustrate how national crisis responses during the euro-area crisis reinforced the sovereign-bank nexus that the Banking Union later aimed to weaken. In Ireland, the blanket guarantee of bank liabilities translated banking losses into sovereign stress. In Spain, banking-sector fragilities required external financial assistance and restructuring. These episodes are relevant to EDIS because they show how, in a systemic crisis, national backstops can become fiscally binding and can amplify fragmentation across the monetary Union (Crimmins, 2010; Halpin and Humphries, 2025; Tisera, 2011).

The Bank of Spain has warned that without the EDIS, the euro area remains vulnerable to financial shocks, as it is crucial for the fulfilment of the EBU's goals. The Portuguese central bank has stressed that the EDIS is still missing, perpetuating fragmentation and reducing financial stability (Aguado and Day, 2019; Reuters, 2013).

Recent Development of European Banking Integration

In October 2020, Croatia and Bulgaria joined the SSM under the “close cooperation” regime, even before adopting the euro. Croatia adopted the euro in 2023, while Bulgaria has announced plans to adopt the euro in 2026 (ECB, 2025). Efforts to deepen the EBU face continuing challenges. The European Stability Mechanism (ESM) reform was intended to establish a common fiscal backstop to the SRF, providing additional funding if the SRF were depleted, but Italy’s refusal to ratify the reform in December 2023 blocked its activation (Fonte and Amante, 2023). Regarding EDIS, the Eurogroup’s June 2022 statement reflected a sequencing of priorities by placing immediate emphasis on strengthening crisis management and national deposit guarantee frameworks through the Crisis Management and Deposit Insurance (CMDI) reform, while acknowledging that the EBU remains incomplete. This sequencing has also shifted political attention toward CMDI as a more immediately actionable reform track than EDIS, as it strengthens crisis-management tools without requiring the same degree of explicit fiscal risk mutualisation (Beck et al., 2022; Eurogroup, 2022; European Parliament, 2025).

The CMDI reform proposal, presented in April 2023, seeks to revise the BRRD to make it easier to liquidate medium-sized banks, allow more flexible use of national funds, and reduce cross-country differences. It provides more tools to the ECB in the resolution process, as well as national authorities and the SRB during the weekend hours of resolution. Additionally, it allows local disruptions, which are typical for smaller banks, to be taken under the public interest test (ECB, 2023; European Commission, 2023; Tamma and Arnold, 2025).

Conclusion, Policy Implications, and Discussion

This paper analyzed the evolution of the EBU and found that the incomplete EDIS remains the primary barrier to achieving a fully integrated and resilient EU banking framework. In 2012, the SSM was established, granting the ECB direct oversight of major banks, followed by the creation of the SRM, designed to resolve failing banks without resorting to taxpayer-funded bailouts. The third planned pillar, the EDIS, remains unimplemented due to persistent political disagreements.

Despite its incompleteness, the EBU remains a significant step toward deeper integration of the EU’s financial sector. Its development reflects both the fragmentation of national banking systems and the persistence of nationally driven interests. Based on the reviewed literature, the primary obstacle to further integration is the unresolved risk-sharing versus risk-reduction debate, which has stalled agreement on EDIS. Germany and its allies tend to favour risk reduction, while Southern countries such as Italy and Spain advocate for risk-sharing mechanisms.

The literature frequently discusses phased or hybrid approaches to EDIS implementation. Beyond the risk-sharing dilemma, structural asymmetries in national banking systems and the political dominance of larger member states continue to perpetuate fragmentation within the EBU and constrain its progress. The literature suggests that without political consensus on balancing risk reduction and mutualization, progress toward completing the EBU is likely

to remain incremental. Accordingly, EU reforms will continue to depend on political compromise among member states over the acceptable scope of collective risk management. Ultimately, the completion of the EBU, and in particular of the EDIS, remains contingent on reconciling persistent political divergences among member states that have so far constrained the scope and depth of further institutional integration.

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