

MORAL HAZARD AND ITS MANIFESTATIONS WITH REGARD TO FINANCIAL SPHERE

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Abstract

The article analyses the historical and theoretical concept of “moral hazard” including the analysis of situations that can be the parts of this economic phenomenon. The space for moral hazard is open every time when people are fully aware of the fact that they will not be obliged to bear full consequences or costs of their behaviour or decisions. The moral hazard may be of a private nature, it is usually connected with the information asymmetry, not effective corporate governance and individual contracts of insurance or guarantee.

Moral hazard may also occur in the public sphere, when a civil servant acts knowing that he will not be responsible for costs of his work or impacts of his poor quality decisions or inactivity. The public sphere may include the field of obligatory insurance. One of the manifestations of the public moral hazard is also the concept “too big to fail”. At first it was connected with big financial institutions, banks and insurance companies, which could not become bankrupt according to government for national economy reasons (example is a part of the New Deal programme). Nowadays, the “too big to fail” approach is extended to big industrial and infrastructure companies, too.

Currently, in the financial sector it is the so called system (international) moral hazard, which is supported and caused in the long run again by the so called government and regulatory rescue measures, which frequently have support in institutionalised rules and customs of international and transnational organisations.

Key words: Moral Hazard, Obligatory Insurance, doctrine “too big to fail”, information asymmetry, European Banking Union

INTRODUCTION

In the last few years, the concept of moral hazard started to be used more frequently in the expert community, mainly with respect to global financial and following debt crisis. Moral hazard was also determined to be one of the causes of the recent financial crisis (e.g. the so called Larosiere Report. Larosiere, 2009). Moral hazard is not a new phenomenon – the others also determined it to be one of the sources of crisis together with the information asymmetry (from world economists e.g. Mishkin in 1992, in the Czech Republic e.g. Frait 2002, Helísek 2004, Revenda 2014).

The main purposes of this article are to clarify the concept of moral hazard including the analysis of situations, which can be part of this phenomenon, also using a historical example, further to find out which economists started to theoretically deal with this phenomenon and when and last but not least to focus on its possible solutions.

1. HISTORY OF THE CONCEPT

Moral hazard appeared for the first time in the economic history at the turn of the 17th and 18th century as a term of English insurance companies in connection with sea cruises. It was used to designate insurance risks, which were not connected with natural or other accidental events, but with a change of behaviour of insured after they enter into insurance. It was a term for a very likely decrease of responsible behaviour and carefulness of the insured people in relation to risks, which costs and effects (damage) were not financially borne by them. The notion for hazardous behaviour was called “moral”. This was not an ethical term, but it is again related to a historical context. An important subject mainly at Scottish universities, but also at Oxford was the so called moral philosophy

(comprising a large area from philosophy, logics, natural law, theory of state and politics to economics). The subject of Moral Philosophy was also taught by Adam Smith (1723–1790) at universities in Glasgow and Edinburgh. The term “moral” was used to designate socially-practical subjects and its contexts in English of the 18th century.

So, moral hazard occurs when a person behaves differently in cases when the risk of his activity is decreased by insurance, guarantee, subsidy, institutionalised dominant market position or other similar fact in contrast to behaviour, when he or she deliberately bears the full risk. The space for moral hazard is open every time when people are fully aware of the fact that they will not be obliged to bear full consequences or costs of their behaviour or decisions; the faith based on past experience that their “problem” will be solved, paid, amortized, forgiven and excused etc. by someone else is sufficient for change of their behaviour.

2. MANIFESTATIONS OF MORAL HAZARD

Manifestations of a behaviour called ‘the moral hazard’ may be of a private or a public nature. According to economic theory, the moral hazard is not a situation when the risk is wrongfully evaluated or an individual decides for an alternative with a high probability of loss but when an individual is responsible for negative impacts. Moral hazard is also not a situation of an illegal conduct (such as an insurance fraud).

2.1 “Private” Moral Hazard

Of a private nature is a less cautious behaviour of an individual or corporation and it appears the most frequently in a situation when *contracts of insurance, guarantee or agency* are entered into. An example is the above mentioned ship insurance.

The next manifestation of the moral hazard is connected with the information asymmetry. It is a problem of delegation – the so called *principal-agent problem*, which is manifested also in corporate governance. The long term process of capital concentration in developed economies is accompanied with an increase of dispersed ownership at the same time. Direct investors are mostly replaced with portfolio investors and they are not able to effectively exercise their rights including the powers of control. This is mainly the case of publicly traded companies and the most frequently in common law countries with the usual use of capital market instruments (stock markets) for gaining capital. Separation of ownership and control leads to conflicts of interest between the owner (principal) and manager (agent), while the information asymmetry favours the “agents”. The interest of the owner is the highest financial profit (having the form of dividend or profit from selling shares) and the interest of managers may be focused on size of the company, its turnover, status and finally may be contrary to profitability of the company (by increasing personal costs, benefits etc.) or may lead to more risky behaviour because possible loss is brought by the owner, not the agent. Paradoxically, the agent may behave opportunistically by not taking business risks and feeling satisfied with average economic results to avoid possible “problems”. The absence of effective corporate governance tools leads to moral hazard of managers.

Principal-agent problem also applies to the relationship between creditor and debtor, landowner and tenant, litigant and his counsellor, investor and his manager and so on.

2.2 “Public” Moral Hazard

Moral hazard may also occur in the public sphere when a civil servant acts knowing that he will not be responsible for costs of his work or impacts of his poor quality decisions or inactivity. Hraba (2009) describes possible moral hazard in public sphere related to judges, public prosecutors, notaries and advocates, when it is very difficult to apply the mechanism of responsibility for maladministration or inactivity and right of recourse.

The public sphere may include *the field of obligatory insurance*. In the Czech Republic it is e.g. obligatory insurance against civil liability for damage caused by the use of a motor vehicle (Act No. 168/1999 Coll., as amended), obligatory insurance of travel agencies against insolvency (Act No. 159/1999 Coll., as amended) and a large complex of the so called obligatory professional liability insurance. According to law, the obligatory insurance shall be taken out by e.g. attorneys (Act No. 85/1996 Coll., On Advocacy, as amended), doctors, auditors, tax advisors, bailiffs, valuation experts.

Czech legislator is (under the influence and in cooperation with regulations and directives of the European Union) concerned with consumer (client) protection, but this also relieves them of the responsibility for consumer decision-making. For example, a client of a travel agency is not surprised by a very low price of offered services, he does not search reactions of previous clients on websites, is not motivated to elementary responsibility etc.

The most noticeable example of moral hazard in the Czech Republic of the last time was the obligatory insurance of bank and savings cooperative deposits. The government protects practically all depositors including those who take high risks and temporarily collect high deposit interests. Deposits of natural and legal persons are insured up to the amount of 100 000 EUR (Act No. 21/1992 Coll., On Banks, as amended and Act No. 375/2015 Coll.). The Metropolitan Savings Cooperative (the biggest Czech savings and loan cooperative until the end of 2013, which provided similar services as banks) offered high increases of deposit value for the long time and depositors were sure that in the case of bankruptcy they will receive a compensation paid by the Deposit Insurance Fund and the savings cooperative could hazardously grant risky loans, because it was sure that it is protected from massive withdrawal of deposits, i.e. a bank run. A lot of clients of this savings cooperative had their deposits intentionally in former bankrupted savings cooperatives and therefore increased the value of their deposits above the standard level.

One of the manifestations of the public moral hazard is also the concept, which is typical for the behaviour of big corporations representatives, the concept *“too big to fail”*. At first it was connected with big financial institutions, banks and insurance companies, which could not become bankrupt according to government for national economy reasons (Frait, 2002).

Nowadays, the *“too big to fail”* approach is extended to big industrial and infrastructure companies and besides national economy reasons for rescue, the social and safety reasons occur. The government rescue of OKD a.s. is currently discussed in the Czech Republic (OKD, a.s. is private joint stock company, which mines black coal in its own coal mines in the North Moravia and Silesia and which generated high profits for its owners in the past; it went bankrupt and demands a subsidy for operation from the government, otherwise it will close the Paskov Mine and dismiss several thousand of miners).

2.2.1 Example of the Public Moral Hazard – New Deal and “Too Big to Fail”

We can see particular manifestations of public moral hazard in economic history much sooner than it was theoretically described; on the contrary, practical manifestations and behaviour of governments on the one hand and entrepreneurs on the other gave impulse for generalising of a typical behaviour: examples of *“too big to fail”* from history are *“textbook”* 1930s in the USA and a part of the New Deal programme focused on rescue of the banking sector.

The biggest stock market crash in the history took place on the New York Stock Exchange on October 24, 1929. This happened after several years of permanent growth, reaching the Dow Jones Index record on September 3, 1929. Just between 1927 and 1929, the overall assets of investment companies increased tenfold. The New York Stock Exchange crash started the so called Great Depression. The following stock decrease stopped as late as in 1932, when stock exchanges reached their minimum and a slow growth came. The Great Depression which arose on American capital markets impacted also the banking sector. More than 5 thousands banks from the overall amount of 24 thousands went bankrupt or suspended payments in the USA between 1929 and 1932. Private gross investments decreased from more than 15 billion dollars in 1929 to less than 1 billion in 1932 and together with a

high unemployment rate (it reached 27 % of active population at its peak in 1933) created a burdensome economic problem (De Soto 2009, p. 477).

The New Deal programme of the newly elected American president F. D. Roosevelt responded to the economic and financial crisis. The attempts of the New Deal using government regulation of economics and social legislation were the first important regulatory period in the economics of the USA, when the government intervention should have restored trust to political and economic system of the country.

Roosevelt decided to close all the banks between March 3 and March 9, 1933, when the Congress drafted a bill of the so called “*Emergency Banking Act*” (prepared by the preceding Hoover’s government). This bill was passed as the first one, immediately on March 9, 1933 and it dealt with the role and insolvency of banks. From the point of this research, it is necessary to mention that it established the government supervision over the banking sector and enabled the Federal Reserve System (the central banking system of the USA) to subsidize banks. [Roosevelt also prohibited private ownership of gold and began to periodically adjust its buying price, he prohibited the export of gold and silver from the USA and tried to untie dollar from the golden standard (its devaluation followed in 1934)].

The act enabled to reorganize and reopen the banks, which were able to survive with the support of the government or the Federal Reserve System. The principle of “too big to fail” became evident here. At the peak of prosperity in the half of 1929, there were almost 25.000 commercial banks in the United States. This amount decreased to 18.000 in the beginning of 1933. When the president Roosevelt called off the bank holiday ten days after its announcement, just 12.000 banks were permitted to reopen and later another 3.000. Overall, during the four years of the crisis approximately 10.000 out of 25.000 banks disappeared – by bankruptcy, mergers with other banks or the liquidation (Friedman, M. & Friedman, R. 1992, p. 88). The universal banking model prevailing in the USA to that time was canceled by the Banking Act from 1933 and the model of strictly divided investment and commercial banks was created (namely by the so called Glass-Steagall Act in 1933).

The institution named “*The Federal Deposit Insurance Corporation*” was created in 1934 and it was providing limited insurance of persons making deposits at banks, which were part of this system. It was an effective way of preventing panic: the Federal Deposit Insurance Corporation secured the deposits against losses to the maximum extent. The insurance ensured depositors that their deposits are safely saved without having to find out information and this enabled again the moral hazard type of behaviour, this time in connection with a behaviour of depositors.

2.3 System (International) Moral Hazard

The problem of moral hazard appeared again during the financial crisis in Europe which started in 2008. In the financial sector it is the so called *system moral hazard*, which is supported and caused in the long run again by the so called government and regulatory rescue measures which frequently have support in institutionalised rules and customs of international and transnational organisations. Financial markets are highly regulated on both national and international level and in the case of the financial crisis we may rightfully talk about failure of governments, regulators and central banks, but not about market failure.

Taking risks in the financial sector became a system one, because many mutually interconnected persons (financial institutions) performed legal operations (either approved or “just” tolerated by public regulators), which made the positions of the others worse. (In the chain of securitization, the mortgage broker was paid by a bank for negotiation, but he was not responsible for debtor “quality” or the financial instrument quality and benefited from an information asymmetry. The same moral hazard occurred in relation to asset managers or stock exchange operators, who received commission for profits gained by using money of the other people, but were not responsible for failure of a respective deal. Concerning the global character of financial markets, the failure of one of the involved parties led to failure of the other party, which subsequently led to lot of adverse impacts.

In financial institutions, there was – and mostly still is – a similar remuneration system of yearly bonuses, which also supported the expansion of moral hazard. Bonuses inadequately reward short-time (annual) success, but do not reflect a risk and suffered losses of financial institutions.

Graphic 1. Vicious circle between banks and their public finances



Source: http://europa.eu/rapid/press-release_MEMO-15-6164_en.htm?locale=en

System character of the moral hazard in financial institutions was intensified by the operation of rating agencies. Governments (acts) passed the part of responsibility for public regulation and awareness to rating agencies, while the rating agencies are private profit-making organisations, furthermore often in the conflict of interests. Rating agencies are partly paid by securities issuers, which put a pressure on the most favourable rating assessment (Bažantová 2010, p. 75 ff).

Also the governments or the political representation supported by international organisations like the International Monetary Fund start to behave in a morally hazardous way nowadays. The European Union countries using the common currency got into the “international” system moral hazard, when one group of countries with financial problems expected and according to set and accepted rules of functioning of the Eurozone expect a help from the second group of countries, which were more cautious and did not get into financial and debt problems.

3. RESEARCH OF THE ECONOMIC THEORY

Theoretical determination of the concept of moral hazard has appeared in the economic theory since the 1960s following the rise of new conservative and institutional theories based on the methodology and approach of the liberal Chicago School, it is a general designation for situations or circumstances promoting risky or highly speculative behaviour of economic subjects.

The liberal School of Public Choice brought to economic theory a basic finding that not only an individual “private” producer and consumer, but also every “public” subject has its own personal interest and it significantly influences its motivation and determines its behaviour. Politicians, government, bureaucracy, but also officers and managers of corporations have personal egoistic interests, which may, but does not have to be identical to the interests of public, which appointed or elected them to their positions, this was demonstrated by one of the leading proponents of the Public Choice School Kenneth Joseph Arrow (*1921) in his book “*Social Choice and Individual Values*” from 1951.

K. J. Arrow wrote an article named “*Uncertainty and the Welfare Economics of Medical Care*” in

1963. In this article, Arrow argued for a significant extension of health insurance, even though the government will become partially responsible for it. He also described risks of moral hazard to which will health insurance lead to. According to Arrow, the ideal case for an insurance is a situation when a person does not have a control over an event for which he is insured, this is for example a case when a person insures against damage caused by meteorite crashing to his house. In the case of health care, insured people (especially, when the insurance is paid by their employer) more probably endanger their health by e.g. smoking than in the case when they have to pay a lung cancer treatment on their own. Further analysis and comments on moral hazard were made in a book *“The Economics of Moral Hazard: Further Comment. In Essays in the Theory of Risk Bearing”* from 1971; K. J. Arrow became the Nobel Prize laureate in economics in 1972.

At the end of 1960s, the phenomenon of moral hazard was dealt with by Mark V. Pauly (Pauly, 1968) and quantification of moral hazard in the field of insurance was made by Joseph Hyman (1972). “Moral hazard in this discussion [Arrow, Pauly, Demsetz, Zeckhauser, Hyman...] is defined to be any misallocation of resources which results when risks are insured with normal insurance contracts and only with such contracts.” (Marshall, 1976, p. 880).

Information asymmetry was theoretically described by G. A. Akerlof (1970) and concerning the model of “principal-agent problem” by the British economist James A. Mirrlees (1975) and B. Holmstrom (1979).

The concept of moral hazard was further elaborated by the laureate of the Nobel Prize in economics in 2001 Joseph Eugene Stiglitz (*1943) together with Richard James Arnott (*1949), focusing on the conditions of tax burden and paying taxes (Arnott & Stiglitz, 1986), also by the proponent of new institutional economics and laureate of the Nobel Prize in economics in 2009 Oliver E. Williamson (*1932), Ron J. Feldman and Garry H. Stern analyse the banking sector with the concept of “bailout” in the book *“Too Big to Fail: The Hazards of Bank Bailouts”* (2004) and others.

3.1 The Most Frequent Causes of Moral Hazard

Economists usually present following sources of moral hazard – the institution of insurance, information asymmetry and government regulation including enacting of obligatory insurance, for financial sector the concept of the lender of the last resort. [The concept of the lender of the last resort was examined in detail during the second half of the 19th century by Walter Bagehot (1826–1877) in the book *“Lombard Street. A Description of the Money Market”* (1873), the rules formulated by him should avoid moral hazard (Revenda, 2014, p. 271-272).]

The so called behavioural economics and its main proponents Vernon L. Smith (*1927) and Daniel Kahneman (*1934), laureates of the Nobel Prize in economics in 2002, give one explanation. Following laboratory psychological experiments, they came to conclusion that inclination to moral hazard is a behaviour “natural to human” (Kahneman 2003, V. Smith 2007).

The next typical cause of moral hazard is a *political failure*, when governments or legislators often respond to market failures by regulation increase of the respective market, creating new regulatory bodies and institutions and primarily by giving government guarantees. Regulation cannot protect against all of the risks. Regulators are too much interested in fighting against previous catastrophes, not mentioning that regulated subjects are usually finding ways, how to avoid regulation. Moreover, in the moment when private investors, consumers etc. begin to rely on regulators, they stop to be careful, which increases a probability of their wrongful decision, they begin to be negligent of measures, which would even partially protect them (portfolio diversification, focus on the quality of contracts, securing, be interested and find information etc.).

This phenomenon was described for the first time by Samuel Peltzman (*1940), an economist at the Chicago University in his article *“The Effects of Automobile Safety Regulation”* from 1975. A described situation – introducing an obligatory using of seat belts while driving and following behaviour of affected subjects – was named by the economic theory as the *“Peltzman Effect”*. Increasing protection decreased risks connected with dangerous driving by mitigating the expected

impacts of an accident, but obligatory use of seat belts simultaneously led to lesser carefulness during driving and the increase of over-speeding cases. People often respond to securing regulation by increasing riskiness of their behaviour. Positive impact of regulation was partially or totally displaced by the so called “offsetting behaviour”, which means compensating activity of individuals.

The Peltzman Effect so explains, why ill-considered government interventions will in conclusions do more harm than good. The way, how the markets were regulated in the past, will in conclusion only make a crisis worse. The reasons for the regulation are actually still present and were not removed by anyone.

This was revealed by an economist Charles P. Kindleberger (1910–2003) in his book “*Manias, Panics, and Crashes*” from 1978, which described moral hazard caused by the fact that the more intervening the governments are in relation to current crisis, the bigger will be the next bubble, because many market subjects will start to believe that government measures will reduce their potential losses.

The contemporary economist, a proponent of the Neo-Austrian School, Jörg Guido Hülsmann (*1966) points out that besides the explanations of “conventional” economic schools, there is also the view of the Austrian School. Although prominent proponents of the Austrian School Ludwig von Mises (1881–1973), Friedrich A. Hayek (1899–1992), Murray Rothbard (1926–1995) and others were not using the word “moral hazard”, they still referred to one of the biggest problems of the modern economy: “Fiat paper money creates moral hazard for the producer because he has the possibility to create *ex nihilo* virtually any amount of money and, thus, to buy virtually any amount of goods and services for sale. The only limit to this capacity is the hyperinflation that in variably results in the case of a great inflation of the money supply. But fiat paper money also creates moral hazard on the side of the money users – the citizens, the banks, and the governments – because they sooner or later come to realise that the masters of the printing press have the power to bail out virtually any bankrupt firm or government.” (Hülsmann, 2006, p. 43-44).

4. PROPOSALS OF SOLUTION

According to mainstream economic theory, the moral hazard is classified as one of the market failures (Bažantová, 2013). Liberal economic schools recommend a restoration of the market balance and removal of market deformations as a general solution. Theoretical solution is restricting government guarantees, restricting solidary liability, introducing different forms of insurance with a system of bonuses and sanctions, setting an indemnity limit during a negotiation of insurance contracts. It is also proposed to reduce consumer protection and transfer liability for decision making or participation in costs for their protection etc. The Austrian school moreover recommends to introduce competitive money (the Free Banking concept).

“Keynesian” economic schools together with current economic practice incline to regulation. So, a more frequent solution is the legal and administrative relementation based on legal norms, establishing regulatory bodies and their functioning, establishing specialised public institutions.

The proposed solution of moral hazard of managers, which means a solution of the principal-agent problem, is choosing a suitable model of legal arrangement including a role and a status of top management. Extensive analyses resulted in two textbook models, the Anglo-American model of corporate governance (monistic, one-tier), when the general meeting elects the board of directors (executive and non-executive) and the German model (dual, two-tier), where a decision making is separated from control and the general meeting elects the supervisory board, which subsequently names the board of directors, while there is an option that one third of the supervisory board is elected by company employees (Bažantová 2015, p. 174) .

With regards to preventing moral hazard in corporations, it is proposed to precise the role of statutory bodies and tighten their liability. Information asymmetry in relation between “principal” and “agent” is among others solved in corporate law by tightening information duties, setting fiduciary duties and a necessity to enter different types of documents in public registers, imposing obligatory audits, publishing remuneration etc. A different solution may be the so called autoregulation, which mean

creating and adhering to ethical codes of behaviour and professional regulation by professional chambers and similar institutions.

In relation to service providers and retailers on one side and consumers on the other, a regulation of the so called consumer contracts, internet purchase, banking and financial services and the whole regulation of consumer protection tightens (duty of a producer or retailer to publish information about the origin of product, its contents, best before date, duty to provide a product with a comprehensible manual, making safety tests etc.).

The risk of moral hazard in a public administration should be mitigated by civil services acts or civil servants act, mechanism of public procurement etc.

4.1 The European Banking Union as a Prevention of a Financial Crisis and of Moral Hazard?

In response to the financial crisis that emerged in 2008, the European Commission pursued a number of initiatives to create a safer and sounder financial sector for the single market. These initiatives, which include stronger prudential requirements for banks, improved depositor protection and rules for managing failing banks, form *the single rulebook* for all financial actors in all Member States of the European Union. The single rulebook is the pedestal of financial sector regulation in the EU in general. It consists of legal acts that all financial institutions (including approximately 8 300 banks) in the EU must comply with. (EC, 2016).

According to politicians, the moral hazard solution in a financial sector and overcoming of financial crises in the European Union shall be a creation of the European Banking Union (The Banking Union members are all euro area countries and those EU member states that choose to participate. The non-euro area Member States of the European Union that have signed the agreement – all except for Sweden and UK – will have to observe the rights and obligations when they have joined the Single Supervisory Mechanism and the Single Resolution Mechanism.)

It is composed of following parts:

- Single rules for functioning of the banking system, which shall be “technical” standards representing binding norms for financial institutions in the European area without a need for transposition.
- Single European banking supervision [*The Single Supervisory Mechanism (SSM)*] carried out by the European Central Bank (ECB) and the national supervisory authorities of the participating countries; the European Central Bank takes over basic powers of national regulators, including among others a power to grant and revoke a banking license, to supervise hazardous bank operations, to monitor adherence to capital adequacy rules. The European Central Bank directly supervises the 129 significant banks of the participating countries. These banks hold almost 82 % of banking assets in the Eurozone (ECB, 2016). The day-to-day bank supervision and protection of banking services consumers shall still remain the power of national bodies in close cooperation with the ECB. Less significant banks continue to be supervised by the national supervisors.
- *The European System of Financial Supervision (ESFS)* is network centered around *the European Systemic Risk Board (ESBR)* and national supervisors and three European Supervisory Authorities. It shall be composed of three newly established European regulators for banking sector supervision [*The European Banking Authority (EBA)*], insurance sector supervision [*The European Insurance and Occupational Pensions Authority (EIOPA)*] and capital market supervision [*The European Securities and Markets Authority (ESMA)*]. The European Systemic Risk Board is based at the ECB’s office and the President of the European Central Bank is also the Chair of the European Systemic Risk Board, but ESBR is not part of the ECB.
- The single system for recovery and restructuring of the banking sector [*The Single Resolution Mechanism (SRM)*] when the European office *The Single Resolution Board* shall among others decide on bank recapitalisation or directly on revoking bank license and terminating their

operation. The Single Resolution Board decides on resolution schemes for failing banks, is directly responsible for the planning and resolution phases of the cross-border and large banks in Eurozone and is responsible for all resolution cases if resolution requires recourse to *The Single Resolution Fund* (SRF). The Fund will be financed by contributions from the EU banking sector, it should reach about one per cent of the amount of covered deposit of all credit institutions in members states. The Fond will be used for resolving the failing banks, after other options, such as the bail-in tool, have been exhausted. (EC, CEU, 2016).

- *The European Deposit Insurance Scheme* (EDIS) with the Paneuropean deposit insurance fund, which shall be established. (According to the rules, all depositors, whether individuals or companies, have their deposits protected up to an amount of 100 000 EUR per bank; depositors are to be reimbursed within a maximum of 20 working days. This time limit will be gradually reduced to 7 working days by 2024.)

The major legislative confirmation is in the Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010.

In the optimistic opinion of the European Commission, the system is designed to prevent banks from being dependent on support from national budgets and from member states' differing approaches to the use of the financing arrangements. This will also help to avoid situations in which bank resolution at national level would have a disproportionate impact on the real economy. A well-functioning Mechanism should significantly reduce the likelihood of bank failures and should ensure that taxpayers are protected from the costs of any bank resolution. (European Commission, 2015).

Graphic 2. Key pieces of the EU-wide financial reform



Source: http://europa.eu/rapid/press-release_MEMO-15-6164_en.htm?locale=en

CONCLUSION

Moral hazard is an important economic phenomenon. The article analysed the concept of “moral hazard” including the analysis of situations that can be a part of this phenomenon, meaning the “too big to fail” problem and principal-agent problem including their typical manifestations. Further, there were mentioned prominent economists who started to theoretically deal with this phenomenon and their contribution, especially K. J. Arrow and S. Peltzman. Last but not least, the article analysed possible sources of moral hazard with regards to the Czech Republic and possible solutions of this phenomenon. One of the system solutions for overcoming a financial crisis according to the European Union politicians should be the concept of the European Banking Union. It is not fully completed, so it is not possible to assess the level of moral hazard relating to new measures and further new regulation. However, we may come to a conclusion based on the above mentioned analysis that the Banking Union will enable a system moral hazard of the European dimension because all (banks and bankers, shareholders, investors, politicians...) will become not cautious because they rely on regulators revealing problems early, especially because there are so much of them, and moreover there are made financial funds to reimburse the losses.

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