IN-DEPTH ANALYSIS

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Tailoring prudential policy to bank size

The application of proportionality in the US and euro area

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Abstract

All jurisdictions tailor their prudential policies to bank size, with generally more complex – though not necessarily more stringent – requirements for larger banks. This paper compares such policies in the euro area and United States, in the context of the differences in banking system structures and legal frameworks. There are vastly more stand-alone smaller banks and credit unions in the US than in the euro area. The US approach to prudential requirements is generally more differentiated by bank size than the euro area's, but the US has a more uniform framework for bank crisis management and resolution. Given the permanence of cross-border fragmentation and overbanking in the euro area, further size-based policy differentiation would be ill-advised.

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LIST OF ABBREVIATIONS

BCBS	Basel Committee on Banking Supervision
BHC	Bank Holding Company
BRRD	Bank Recovery and Resolution Directive
CBRL	Community Bank Leverage Ratio
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ECB	European Central Bank
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHFA	Federal Housing Finance Agency
FSB	Financial Stability Board
GSE	Government-Sponsored Enterprise
G-SIB	Globally Systematic Important Bank
IPS	Institutional Protection Scheme
LSI	Less significant institution
MREL	Minimum requirement for own funds and eligible liabilities
NCUA	National Credit Union Administration
NPL	Non-performing Loan
OCC	Office of the Comptroller of the Currency
OLA	Orderly Liquidation Authority
SI	Significant institution
SRL	Supplementary Leverage Ratio

SME	Small or Medium Enterprise
SNCI	Small Non-Complex Institution
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
TEU	Treaty on European Union
TLAC	Total Loss-Absorbing Capacity

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EXECUTIVE SUMMARY

Prudential policy frameworks generally entail some differentiation of requirements and practices based on the systemic importance of, and risk presented by, regulated institutions, for which balance sheet size is an imperfect but widely-considered proxy. Such differentiation, generally called tailoring in the United States, is often referred to as 'proportionality' in Europe. Because the interplay between this concept and the European Treaty principle of proportionality is ambiguous, we use the US term 'tailoring' in this paper.

A comparison of tailoring choices in the euro area and the United States must include awareness of the different market structures in the two jurisdictions. We start our analysis with a broad mapping of the respective structures, despite stark differences in data availability, and taking into account the specificities represented by institutional protection schemes (IPSs) and promotional banks in the euro area, and by the widespread presence of non-bank credit unions and government-sponsored enterprises (GSEs) in the United States. Our analysis shows there are considerably more stand-alone smaller credit institutions in the US than in the euro area, with combined assets representing a share of the system's total more than twice as large as in the euro area. This fact stems from the two jurisdictions' vastly different histories, and is often neglected in European policy debates.

Tailoring is a response to several policy objectives and trade-offs. Compliance with prudential requirements involves fixed costs that create a comparatively larger burden for smaller regulated institutions. Competition policy considerations may lead to the introduction of tailoring, to offset size-linked distortions. Smaller banks may also be favoured for reasons unrelated to prudential policy objectives, such as their role within local communities. At the same time, by favouring banks of a certain size range or type, tailoring may fragment markets, and undermine the level playing field objective.

Surveying prudential policies, namely regulation and licensing, supervisory legislation and practice, and crisis management, we find that the US takes a generally more differentiated approach to prudential regulatory requirements than the euro area, driven primarily by bank size. By contrast, the US framework for bank crisis management and resolution is more uniform than in the euro area.

Euro-area policymakers have introduced a number of tailoring measures in the bank prudential framework in the last decade. Yet, they have resisted going as far as the US on the grounds that it would erode the level playing field within a still poorly integrated banking market, which is overcrowded with too many uncompetitive banks. Even though a full analysis of policy trade-offs is beyond the scope of this paper, it is clear that addressing these first-order structural issues should take priority over other considerations that could justify further tailoring. As a consequence, we suggest that any further tailoring should only be considered, if at all, once significant progress has been made in reducing cross-border fragmentation and eliminating overcapacity in the euro-area banking sector.

1. INTRODUCTION

The economic crisis that arose from the 2020 pandemic outbreak was the first major test, after the great financial crisis and the euro-area crisis, of how well the euro-area banking sector was prepared for a major shock. The comprehensive round of regulatory reforms of the early 2010s included the first Capital Requirement Regulation (CRR) and fourth Capital Requirements Directive (CRD) transposing the Basel III accord; the introduction of a harmonised resolution regime for failing banks with the Bank Recovery and Resolution Directive (BRRD); and the supranational banking policy integration effort in the euro area known as banking union. In the event, euro-area banks not only withstood the COVID-19 shock well but have even played a part in the subsequent recovery, becoming a conduit for significant volumes of government guaranteed credit.

At the same time, some long-standing structural problems in the euro-area banking system remain unresolved. Banks in the euro area continue to suffer from a structural lack of profitability (ECB, 2020). The lack of progress with financial integration and risk sharing through the establishment of truly cross-border banks remains a fundamental vulnerability within the currency union. The challenge to established banks has become more pressing because fintech companies and other non-bank financial institutions have gained market shares, and new business models are needed which are better suited to the digital age.

EU prudential policy is aimed at the safety and soundness of institutions and stability in the broader financial system. It partly relies on the global standards set by the Basel Committee on Banking Supervision (BCBS). These global 'Basel' standards, however, are specifically intended for internationally active banks, whereas the EU has long opted to apply them across all banks irrespective of size. Even so, EU law and policymakers acknowledge the importance of tailoring prudential policy for smaller institutions in line with their differentiated significance for financial stability. The reforms of the 2010s introduced extensive tailoring in supervision (Jochnick, 2019) and regulation (Würmeling, 2021). At the same time, financial integration and a competitive level playing field have been important complementary objectives, on which only marginal progress has been made, and which could be undermined by a wider application of tailoring.

Prudential policy inevitably affects industry structure and the competitive level playing field. The Basel III accord, the first components of which were finalised in 2010, has raised requirements considerably, including on liquidity, funding, leverage and governance. It has been largely implemented alongside the EU's banking union. Simultaneously, key attributes of resolution regimes issued by the Financial Stability Board (FSB) have inspired the EU and euro-area bank resolution frameworks. Two key planks of EU regulations are being reviewed in 2021 – the finalisation of Basel III implementation within the CRR/CRD, and the crisis management and deposit insurance framework including but not limited to BRRD. These processes inevitably reopen a long-standing debate on tailoring.

Financial policies in the euro area are frequently compared to those in the US, a market that has over two centuries of banking and capital market evolution politically embedded in a federal context. This paper examines this comparison in the area of prudential policy tailoring. To do so, we compare key aspects of banking sector structures, and of policies applying to different categories of credit institution. Our paper considers a broad range of prudential policy issues, including licensing and the prudential rulebook, supervision, and resolution and deposit insurance. It generally does not touch upon other significant matters of banking sector policy such as anti-money laundering or conduct-of-business regulation, including consumer compliance, taxation and, in the United States, enforcement of the Community Reinvestment Act.

The paper is organised as follows. In section 2, we provide context by comparing the banking sectors in the euro area and US. In section 3, we clarify the semantics of proportionality and tailoring in the EU and euro area, and set out how they may fit with the objectives of prudential policy. In section 4, we describe the application of differentiated prudential policies in the euro area and in the US. Section 5 concludes with reflections on the trade-off between tailoring and key supervisory objectives.

2. BANKING SECTOR STRUCTURES IN THE EURO AREA AND UNITED STATES

European debates on tailoring often do not take sufficiently into account how the euro-area banking structure differs from that of other jurisdictions. In the specific case of the US, we find a considerably larger number of smaller institutions, which are collectively much more significant than in the euro area. We detail the main idiosyncrasies and data gaps in the three first subsections below, before presenting stylised findings in subsection 2.4.

2.1. Scope of analysis

In general, US law and practice use a somewhat more restrictive definition of 'bank' than is the case for credit institutions subject to CRR/CRD in the European Union – in line with common practice, we also refer to the latter as banks in the EU context. In both jurisdictions, for historical reasons, there exist non-banks, i.e. institutions that are not subject to policy framework that apply to entities defined as banks. Non-banks play an economic role similar to banks but are regulated differently. In EU law, 'credit institutions' are defined in the CRR as *"undertaking*[s] *the business of which is to take deposits or other repayable funds from the public and to grant credits for* [their] *own account"*[1]. This definition is comparatively broad because *"other repayable funds"* includes a range of non-deposit instruments and thus a credit institution can be a bank even if it takes no deposits. In the US, by contrast, all banks are deposit-taking ('depository') institutions.

The CRD exempts from its provisions a number of credit institutions that it lists specifically[2]. Apart from central banks, these include a number of public-purpose financial institutions, or 'non-CRD promotional banks'[3], and a number of generally tiny institutions in several member states, or 'credit unions'[4, 5].

The word 'bank' in the United States refers near-universally to credit institutions that are authorised to accept deposits under federal deposit insurance provided by the Federal Deposit Insurance

[1] Regulation (EU) 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, Article 4(1)(1).

[2] Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, Article 2(5), subsequently amended by Directive (EU) 2019/878 of 20 May 2019, Article 1(1).

[3] These are, in the order listed in the 2019 revision of the CRD: *Eksport Kredit Fonden*, *Skibskredit* and *KommuneKredit* in Denmark; *Kreditanstalt für Wiederaufbau*, *Landwirtschaftliche Rentenbank*, and 13 *Land*-level entities known as *Fôrderbanken* or *Landesförderinstitute* in Germany; the Strategic Banking Corporation of Ireland; Ταμείο Παρακαταθηκών και Δανείων (Tamio Parakatathikon kai Danion) in Greece; *Instituto de Crédito Oficial* in Spain; *Caisse des Dépôts et Consignations* in France; *Cassa Depositi e Prestiti* in Italy; the Dutch Investment Bank for Developing Countries (*Investeringsbank voor Ontwikkelingslanden*) in the Netherlands; *Kontrollbank* in Austria; *SID Banka* in Slovenia; Finnfund and Finnvera in Finland.

[4] This semantic convention is in line with the practice of the European Network of Credit Unions, which brings together most though not all of the corresponding entities, even though different names are used in national languages of some of the relevant member states.

[5] In addition to these, additional institutions are exempted from the CRD, including a handful of national postal giro institutions and other entities, but we estimate their aggregate significance to be limited.

Corporation (FDIC). The FDIC uses the term *"Insured Depository Institutions"* as synonymous to banks[6]. This definition leaves credit unions, which also take deposits but with restrictions on their customer base and activities, outside of the scope of 'banks' in common US parlance. US credit unions thus exist under a separate regulatory and deposit insurance framework, which is operated by the National Credit Union Administration (NCUA). They are collectively far from negligible (subsection 2.4). In the past, another separate category of deposit-taking institution was formed by savings (or savings and loan) associations, also known as 'thrifts'. Thrifts still exist but the policy framework that applies to them has for more than a decade been almost entirely integrated into that for banks, and we therefore do not differentiate between thrifts and banks. GSEs in the US play a role somewhat comparable to that of promotional banks in the EU, particularly in mortgage credit and agricultural credit[7].

Partly because US depository institutions are regulated differently from non-depository ones, the legal structure of larger banks in the US differs from that of most of their EU counterparts, in that the parent group entity is non-depository, or in other words, not a bank. The parent entities of diversified banking groups (i.e. groups that include one or several depository banks but also other financial services firms, such as broker-dealers) are regulated under US law as 'bank holding companies' (BHCs) and are subject to specific prudential requirements. In the EU, there is also specific legislation applying to banking group holding entities, but unlike in the US, these are often banks themselves and subject to the corresponding prudential framework.

2.2. Data limitations

In the United States, an extensive system of quarterly reporting and disclosure allows for a highly granular analysis of banking system structures, with reams of relevant information accessible through the portal of the Federal Financial Institutions Examination Council (FFIEC), which brings together the key supervisory authorities. So far, no similar transparency exists at EU or euro-area level, while at member-state level the level of transparency is generally also much inferior to US practice (Gandrud *et al*, 2016)[8].

Progress of a sort was achieved with the introduction in the euro area of the distinction between significant institutions (SIs) and less-significant institutions (LSIs), together with the banking union policy initiative, as further explained in section 4. Lacking disaggregated bank-level information, we use data aggregated by the European Central Bank for LSIs and SIs respectively. This has been provided every year since 2015 at euro-area level, and on a country-by-country basis in a 2020 publication (ECB, 2020)[9].

A significant share of banks in both the euro area and US are foreign-owned, including a number of euro-area LSIs and smaller US banks that are part of large global banking groups. Data shared with us by the ECB suggest that 136 LSIs, or 18 percent of the euro area's 740 stand-alone LSIs (see next

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[6] Industrial Loan Companies are generally distinguished from banks but are also FDIC-insured and we bundle them with banks. Their aggregate significance is limited, in any case.

[7] They are: the Federal National Mortgage Association, known as Fannie Mae; the Federal Home Loan Mortgage Corporation, known as Freddie Mac; 11 Federal Home Loan Banks; the Federal Agricultural Mortgage Corporation, known as Farmer Mac; AgFirst; AgriBank; and the Farm Credit Bank of Texas.

[8] The transparency exercises periodically coordinated by the European Banking Authority provide much more information, but only on the largest institutions.

[9] Our analysis here is based on an update of these data for end-2020, graciously provided to us by the ECB, which also provided a clearer disaggregation between LSIs that belong to an IPS and those that don't.

subsections) belong in that category, with possibly an even larger share in terms of total assets. Given data limitations, however, we have not disaggregated these from domestic stand-alone smaller credit institutions, unlike those in IPSs (next subsection) – and even though they may not necessarily be considered stand-alone for policy purposes, depending on the prospect for parent support in the event of severe difficulties. For comparability purposes, foreign-owned banks are also included in our numbers for the United States.

Compounding the data challenge, accounting and auditing frameworks vary widely across member states and between euro-area banks, credit unions and promotional banks (Véron 2020).

Overall, comparative analysis of euro-area banking structures cannot be done to nearly as granular a level as what is possible for the US.

2.3. Stand-alone institutions versus institutional protection schemes in the euro area

In the euro area, another significant distinction is between banks that stand alone and those that benefit from mutual support arrangements, such as those provided by what EU law refers to as institutional protection schemes (IPSs). Even though IPSs currently exist only in four member states (and are very small in two of these), they are a significant component of the system in aggregate and require understanding for an informed policy debate.

Currently there are five IPSs that involve LSIs in the euro area[10]:

- The *Raiffeisen* cooperative banks in Austria;
- The German public banks that form the Savings Banks Group (*Sparkassen-Finanzgruppe*);
- The German cooperative banking group (*Genossenschaftliche Finanzgruppe Volksbanken Raiffeisenbanken*);
- *Raiffeisen* cooperative banks in the South Tyrol region of Italy;
- The Rural Savings Group (*Grupo Caja* Rural) in Spain.

IPSs bring together credit institutions that are operationally separate from each other, and thus do not meet the legal criteria for consolidation within a single banking group, but which support each other in cases of financial stress and also often share brands and services. In the case of IPSs, this support takes the form of a specific *ex-ante* commitment, which provides advantages in terms of the regulatory treatment of exposures between banks that belong to the same scheme. Also, in most euro-area IPSs a 'regional principle' applies, meaning that local member banks do not compete with each other since each has exclusivity for the IPS on its assigned territory. Similar arrangements have existed historically in the United States, but were brought to an end by the savings and loan crisis of the 1980s and early 1990s (Kane, 1989; Todd, 1994).

Institutional protection schemes can mitigate risk by mutualising it, but can also lead to risk accumulation when most or all participants in the arrangement have correlated risk profiles. In the United States, such correlated exposures were a key driver of the savings and loan crisis of the 1980s, which led to the disappearance of the remaining state-level mutual support arrangements in the US banking sector. Similarly, a number of mutual support networks in various EU member states have reorganised themselves and are now regulated and supervised as integrated groups, even though their

[10] A sixth one, Austria's *Haftungsverbund der Österreichischen Sparkassen*, does not involve any LSI as it is fully consolidated into Erste Group Bank.

operating and decision-making structures remain highly decentralised. These include, to various degrees, Erste Group in Austria; OP Group in Finland; BPCE, Crédit Agricole and Crédit Mutuel in France; Cassa Centrale Banca – Credito Cooperativo Italiano and Iccrea in Italy; and Rabobank in the Netherlands, all of which are SIs.

For the purpose of financial stability and prudential considerations, banks that belong to IPSs evidently present very different patterns of risks and challenges than stand-alone entities. If the mutual support pledge is credible, as is generally the case for smaller institutions, then those banks will not fail, but correlated fragility in many of them could endanger the entire IPS structure. In other words, individual IPS members do not contribute to systemic risk given the institutional protection they benefit from, yet the systemic risk profile of the IPS as a whole is akin to that of a bank as large as the combination of all the IPS members. Also, IPSs reduce regulatory costs for their member institutions, because they provide common resources for compliance and information system that benefit from IPS-wide economies of scale. Thus, the rationale that underpins tailored prudential policies for stand-alone smaller banks does not translate to smaller banks that are IPS members. In any discussion of tailoring policies in the euro area, a clear distinction must therefore be made between stand-alone LSIs on the one hand, and LSIs within an IPS on the other.

2.4. A mapping of credit institutions in the euro area and US

Balance sheet size is the main justification for tailoring prudential requirements. Table 1 summarises the relative importance of smaller and larger credit institutions in the euro area and United States, including banks, credit unions, promotional banks and GSEs. Figure 1 summarises the data on each category's assets. These charts underline a number of differences and similarities between the two markets.

Most strikingly, after adding credit unions and correcting for IPSs, there are 8.3 times more stand-alone smaller credit institutions in the United States than in the euro area (10,089 versus 1,212). These also represent a larger share of the system's total assets: 12.9 percent versus 8.9 percent, once the euro-area LSI sector has been corrected for IPS structures. This is despite our use of a lower threshold between 'smaller' and 'larger', which skews the comparison: $10bn in the US vs €30bn in the euro area. If €30bn ($36.81bn) is used in the US instead of $10bn, the respective numbers become 18.4 percent versus 8.9 percent. In other words, using a true 'apples-to-apples' approach, the relative weight of smaller institutions is more than twice as large in the US as in the euro area[11]. Credit unions are collectively a hundred times more significant in the United States than in the euro area, with 5 percent versus 0.05 percent of the system's total assets.

In the euro area, LSIs that are members of IPSs collectively account for about as large a volume of assets as stand-alone LSIs. As for promotional banks (outside of CRD scope) and GSEs, they are comparatively few in number but an important component of the system in both the euro area and the US, particularly in the latter, where they represent over a fifth of total assets.

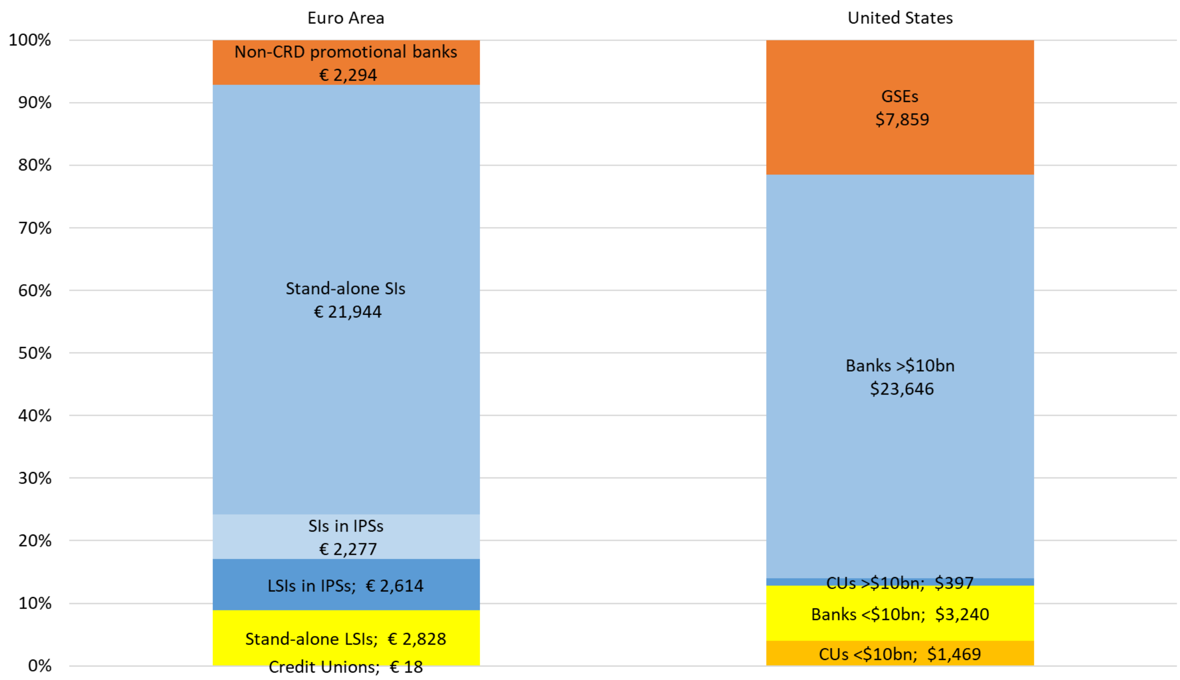
Table 1: Banking sector structures in the US and euro area, end-2020

[11] In order to compare accurately like-for like, it would be desirable to add to the total of (stand-alone) LSI assets the assets of those SIs that fall under the €30bn threshold. The ECB does not provide relevant disaggregated information, but based on its list of supervised institutions as of 1 January 2021, there are at most 30 such SIs. By construction, their combined assets cannot be more than 30 x €30bn = €900bn (2.8 percent of system total), and are presumably only a fraction of that number. Thus, we reckon that our finding of a factor of more than two between euro area and US is robust against that possible correction.

Euro area			United States		
	Number	Assets €bn		Number	Assets $bn
Smaller credit institutions					
Credit unions (all <€30bn)	455	18	Credit unions under $10bn	5,190	1,469
Stand-alone LSIs	740	2,828	Banks under $10bn	4,899	3,240
Larger credit institutions					
Stand-alone SIs	99	21,944	Credit unions above $10bn	16	397
SIs in IPSs	15	2,277	Banks (BHCs) above $10bn	151	23,646
LSIs in IPSs	1,524	2,614			
Promotional banks and GSEs					
Promotional banks exempted from CRD	28	2,294	GSEs	17	7,859

Sources: For the euro area: data on SIs and LSIs, including the split between IPS members and other LSIs, were made available by the ECB; other data from the European Credit Union Network (http://www.creditunionnetwork.eu/cus_in_europe; data as of end-2019) and from individual annual reports of promotional banks. For the US: data on banks from the FFIEC portal; data on large BHCs from the Federal Reserve's National Information Center through the FFIEC portal, ; data on credit unions from NCUA call reports; and data on GSEs came from their respective annual reports.

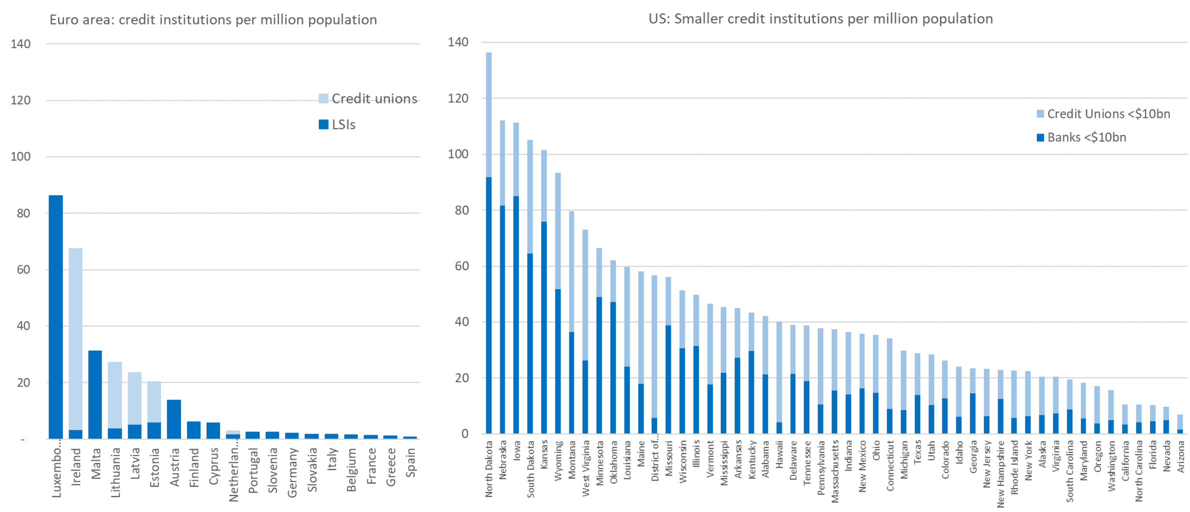
Figure 1: Distribution by assets



Sources: as in Table 1.

The greater presence of smaller credit institutions in the US is not the consequence of a specific geographic concentration, but can be observed throughout the territory. Given that the euro area and the United States have roughly the same population (342m vs 328m), our analysis also implies that the density of smaller credit institutions (their number per unit of population) is significantly higher in the United States than in the euro area. This is true jurisdiction-wide, and also generally at the level of individual (member) states as illustrated by Figure 2. Indeed, only nine member states, which together represent only 8 percent of the euro-area population, have more than five stand-alone smaller credit institutions (LSIs and credit unions) per million population. Furthermore, in Ireland and the Baltic States, these are mostly credit unions that tend to be tiny. By contrast, all US states without exception have more than five smaller credit institutions (banks and credit unions under $10bn in total assets) per million population [12].

Figure 2: Density of stand-alone smaller credit institutions in the euro area and United States

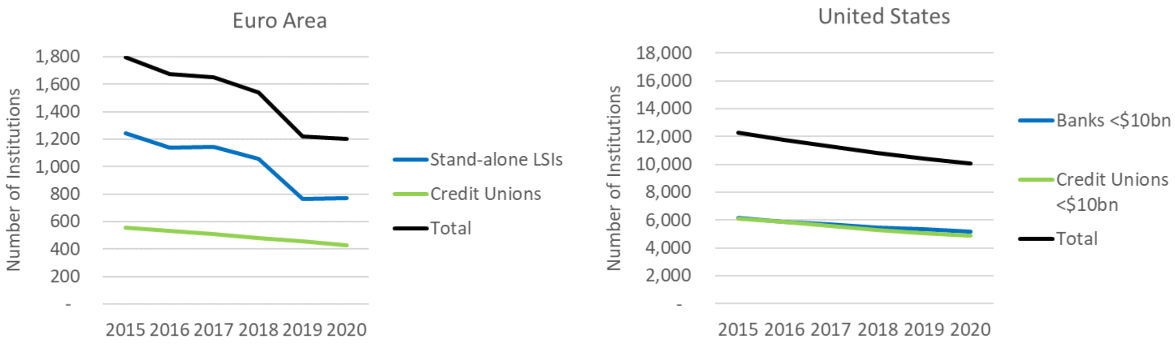


Sources: as in Figure 1, with additional population data from Eurostat (as of end-2019) and the US Census Bureau (as of mid-2019).

Looking at time series, we observe a general trend of reduction of the number of smaller institutions in both the euro area and the United States. This is illustrated by Figure 3.

[12] Again, this finding emerges even though we used a lower threshold of assets of $10bn in the US versus (generally) €30bn in the euro area.

Figure 3: Evolution of the number of stand-alone smaller credit institutions in the euro area and United Sates



Sources: same as Table 1*, Deutsche Bundesbank, Austrian National Bank. To calculate the number of stand-alone LSIs over time, we took the total number of LSIs from the ECB's successive annual reports on supervisory activities, and took the total of German savings banks and cooperative banks and Austrian Raiffeisen banks as proxy for LSIs in an IPS. This proxy is plainly imperfect but we estimate that the resulting orders of magnitude are meaningful. For European credit unions, we extrapolated the 2015-2019 trend to estimate the number for 2020.*

3. TAILORING AND PROPORTIONALITY

3.1. Semantics

As is often the case, differing terminologies complicate a comparison between the EU and the US. Before describing the respective policy frameworks, it is useful to further clarify what is meant by the key expressions.

'Tailoring', a term commonly used by US regulators, refers to the differentiation of prudential requirements and practices depending on a regulated institution's size. This does not necessarily imply that these requirements are altogether less demanding for smaller banks than for larger ones, as will be made clear in subsection 4.3.

'Tiering' refers, at least in some publications, to the existence of materially different policy frameworks for banks of different categories or size ranges (e.g. Joosen *et al*, 2018)[13]. Tiering thus defined may be suited to systems in which there is a wide gap between, for example, a limited number of very large banks and the rest of the banking sector. Switzerland is the quintessential example of such a situation, where Credit Suisse and UBS dominate the domestic banking landscape (e.g. FINMA, 2011). That is not, however, the case in either the euro area or the United States, where bank size is widely distributed and the application of prudential requirements is therefore more graduated (Castro Carvalho *et al* 2017). The ECB has specifically rejected the idea of a two-tier system for the euro area (Jochnick, 2019).

'Proportionality' is a key legal principle enshrined in the Treaty on European Union (TEU)[14]. A considerable body of jurisprudence and literature has refined its meaning and significance. Its application in the area of prudential policy remains ambiguous and continuously debated (Zilioli, 2017). Meanwhile, in recent years, the same term proportionality has increasingly been used by the Basel Committee on Banking Supervision and other bodies hosted by the Bank for International Settlements (see subsection 4.1).

Thus, proportionality in the context of EU banking sector policy may refer to two overlapping but distinct considerations, and different policymakers have given different definitions for it (e.g. Lautenschläger, 2017; Angeloni, 2018; Restoy, 2018b; Hakkarainen, 2019). First, proportionality as referred to in Article 5 TEU implies that requirements should not be excessive (or disproportionate) with regard to the policy's objective(s). This understanding of proportionality supports, in particular, notions of 'better regulation' such as impact assessments. Second, proportionality as referred to in recent Basel documents implies tailoring in relation to systemic importance and risk, with size (e.g. total assets) often serving as a proxy metric. To avoid confusion between these two notions, this paper generally refers to tailoring, recognising the fact that similar ideas have often been referred to as 'proportionality' in EU banking policy debates.

[13] The Financial Stability Institute has referred to the same concept as the *"categorisation approach"* (Castro Carvalho *et al*, 2017).

[14] Article 5 TEU states that *"The use of Union competences is governed by the principles of subsidiarity and proportionality" and further that "Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties."* This proportionality principle first appeared in EU legal jurisprudence in 1970, before being incorporated into the Treaty of Maastricht and later into the Charter of Fundamental Rights of the European Union.

3.2. Rationales

Three rationales have been proposed to justify applying size-based tailoring in prudential regulation and supervision (Angeloni, 2018).

The first is that the smaller institutions may have simpler and safer business models so that financial stability benefits are limited relative to compliance costs. The costs to a specific institution of understanding, interpreting and operationalising an individual prudential regulation have a large, fixed component, and will therefore affect smaller institutions disproportionately[15]. Where a bankmust comply with a new regulatory requirement, this will absorb resources in terms of staff, IT capacity and legal and accounting expertise. These compliance costs are largely independent of the bank's revenues or asset base. Studies on the long-running lack of profitability in the euro-area banking sector point in particular to a weak set of smaller institutions (ECB, 2020). These costs will need to be weighed against benefits arising in terms of the safety and soundness of an individual institution, and overall financial stability, which may be limited depending on the nature of the institution and its loan portfolio. There may indeed be unintended effects if regulation is applied across all institutions if the earnings of smaller banks are depressed leading to more risk-taking and reduced resilience. It should also be noted that new regulatory compliance ('regtech') technology-enabled services may significantly modify the economics of compliance in the near future.

Each regulation will also affect the relative cost of financial products. Smaller institutions may shift from highly regulated products, such as mortgages, to other loan types, and reduce consumer financial choice in the process. Moreover, financial sector assets may shift to other providers which are less regulated or not regulated at all. Regulatory arbitrage and the rapid growth of the non-bank financial sector in Europe can in part be attributed to the intense pace of banking regulatory reform in the period following the global financial crisis (IMF, 2014).

A second rationale for tailoring in prudential policy lies in the dynamic effects of regulation on competition and innovation in the financial sector. Entry into the sector may be discouraged if smaller institutions face the entire raft of regulation and supervision. Conversely, prudential policy differentiation according to size would create barriers to growth or cliff effects. Smaller credit institutions will be discouraged from growing beyond the thresholds set in regulation, reducing competition in the sector, and the efficiency and resilience of *all* firms. Should a larger firm fail and be wound down, smaller firms would be less likely to grow and take its place.

A third and final rationale could lie in the special role smaller institutions have within the local economy. There is some empirical evidence of the benefits of more stable relationships between banks and local SMEs and households (e.g. Elsas and Krahnen, 1998; Schäfer, 2016). Yet, this role does not necessarily support the case for a lighter treatment in terms of prudential requirements and enforcement.

Even if tailoring is widely applied in prudential policy, regulators, supervisors and resolution authorities will interpret it in different ways, each according to their own specific mandate. In regulation, tailoring would seek to avoid excessive compliance costs for individual institutions which are out of line with financial stability benefits, and thereby maintain a competitive level playing field in the sector. Risk-based supervision would normally focus scarce resources on those institutions most at risk of failure, which may include smaller banks. Resolution policy aims at preparing for and managing the failure of banks with minimal disruption to financial stability, and avoiding the costs of failures falling on the taxpayer (Restoy, 2019).

[15] This is the so-called complexity problem in terminology introduced in Bank of England (2021).

4. TAILORING POLICIES IN THE EURO AREA AND THE UNITED STATES

This section starts with a brief reminder of the international framework, before describing current arrangements in the euro area and US respectively. When looking at the extent of tailoring, we did not attempt to compare the strengths of the respective arrangements, or their effectiveness or efficiency. For example, the US imposes higher capital requirements on many banks than the EU, but we left this kind of assessment outside the scope of the paper. We also leave aside the important issue of (non-)compliance with Basel standards for those banks that are internationally active. Even on tailoring, our analysis is far from exhaustive, and only focuses on those items that we view as most significant.

4.1. International standards

The prudential standards known as Basel agreements are designed for internationally active banks. For such banks, they define a level playing field in order to prevent competitive distortions between different relevant markets, as reduced prudential standards could result in cross-border spill-overs (FSI, 2018). With the exception of what are defined as global systemically important banks (G-SIBs), which are listed every year by the FSB, members of the Basel Committee on Banking Supervision (BCBS) are free to define which banks are deemed internationally active. The FSB's standards for bank resolution regimes (known as 'key attributes') are similarly intended for internationally active banks.

Neither the Basel I (1988), Basel II (2006) nor initial Basel III (2010) accords used the language of proportionality. That word appears to have entered the Basel lexicon in the 2012 revision of the *Basel Core Principles of Banking Supervision*: the 2012 iteration of Principle 8 on supervisory approach thus states that *"An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, **proportionate to their systemic importance**"* (BCBS 2012; our emphasis).

Several recent surveys by the Basel Committee underline the wide use of tailoring in most jurisdictions. The major jurisdictions represented in the Basel Committee generally apply Basel standards only to mid-sized and larger banks with balance sheets beyond a certain size (Castro Carvalho *et al*, 2017; BIS, 2019). Smaller banks are often subject to a modified Basel standard, or to entirely different and simpler prudential rules. A survey of 94 non-BCBS jurisdictions also showed that proportionality is applied widely, and that many jurisdictions consider newly introducing such elements or modifying the existing application (World Bank and BCBS, 2021).

The EU is exceptional in its wide application of Basel rules to all banks. Illustrating that exception, when the United Kingdom exited the single market in 2020, it announced that it would grant wider exemptions and adopt new prudential regulation differentiated according to the size and complexity of the supervised institutions (Bank of England, 2020), likely from 2022. All key elements of the regime remain subject to a consultation, including the definition of smaller and less-complex institution that would benefit, the simplified requirements and how firms would transition out of the special regime. Research by the Bank of England suggested that continued full application of Basel III rules would reduce the earnings of smaller banks, raise their risk appetite and possibly even lead to reduced resilience (Bank of England, 2020 and 2021; Lehmann, 2021).

4.2. Tailoring in the euro area

EU prudential policy is focused on the safety and soundness of individual institutions and financial stability, and aims at minimising the likelihood of taxpayer-funded bailouts. Unlike some other financial sector supervisors, the ECB has no secondary mandate, such as competition, financial inclusion or international competitiveness (Kirakul *et al*, 2021). However, at least two complementary objectives have been invoked by supervisors: the efficiency and competitiveness of banks, and cross-border financial integration (Jochnik, 2019). There has been only marginal progress on these objectives since the euro-area banking union came into effect in 2014.

Even though the numbers of banks and bank branches have fallen steadily in euro-area countries, there is still considerable over-capacity (ESRB, 2014). The cost-to-income ratio, a broad measure of efficiency, has not fallen markedly for either significant or less-significant institutions (ECB, 2020). Considerable uncertainty over asset quality and the earnings outlook in the low interest environment has until recently depressed price-to-book ratios (ECB, 2019). ECB indicators such as cross-border lending or inter-bank exposures show that there has been limited progress on the integration of national banking markets since the inception of the banking union, even while the differences in the cost of credit have narrowed. Cross-border banking through the establishment of branches and subsidiaries elsewhere in the euro area has not become more attractive (Angeloni, 2020).

Limited efficiency and competitiveness, as well as the absence of true risk sharing through cross-border integration, remain underlying weaknesses in the euro-area financial system. This underlies the reluctance of policymakers to extend tailoring of prudential requirements more widely (Jochnick, 2019). According to this line of argument, the application of demanding prudential standards to smaller institutions raises incentives for consolidation and mergers and prevents national banking sectors, which may demand exemptions on account of their specific business models, from being sheltered from cross-border competition within the euro area. Even so, elements of tailoring are present in all three areas of prudential policy.

4.2.1. Licensing and regulation

The uniformity and coherence of bank prudential standards has been a longstanding EU objective that has been maintained since the great financial crisis. The EU's single rulebook therefore applies to all financial institutions in the single market. Moreover, with banking union, all euro-area banks are licensed by the ECB (which took over all existing bank licenses from national authorities in 2014). The ECB is also responsible for license withdrawals and modifications, among other so-called common procedures.

Yet the CRR and CRD make several explicit references to the rationale for tailoring. For example, Recital 46 of CRR states that *"the provisions respect the principle of proportionality, having regard in particular to the diversity in size and scale of operations and to the range of activities of institutions"*. Similar references are made in CRD IV, including on internal governance (Art. 74), remuneration policies (Art. 75), risk management (Art. 76) and the Supervisory Review and Examination Process (SREP; Art. 97). Under the CRR, the Commission is required to ensure that relevant binding technical standards and the application of the regulation comply with the proportionality principle. The 2019 revision of CRR also created a category of small and non-complex institutions (SNCI), for which reporting requirements are simplified, while capital and liquidity requirements remain essentially unchanged. The ECB has advised against revisiting the balance thus achieved (Enria, 2019).

Future regulatory changes are also set to have a differentiated impact depending on the size and complexity of banks. The final elements of Basel III, published in late 2017, require use of the so-called output floors in the calculation of capital coverage in banks' internal models. These internal models are primarily used by larger banks, while smaller banks primarily use the simpler standardised approach. Additional capital requirements will therefore predominantly affect larger banks. The European Banking Authority (EBA) estimated that of the overall capital shortfall of €52 billion resulting from the implementation of the final phase of Basel III, would be largely borne by the larger banks (EBA, 2020). Small and medium institutions (largely LSIs) would be largely unaffected by the changed approach, as they continue to calculate risk coverage under the standardised approach.

4.2.2. Prudential supervision

While the EU's regulatory framework is relatively uniform and applied widely, prudential supervision is highly differentiated in practice.

The Single Supervisory Mechanism Regulation of 2013 created what is arguably the most significant element of tailoring in EU banking law, namely the distinction between SIs and LSIs in its Article 6. SIs, of which there are currently 114, are identified mostly on the basis of asset size and their dominance of national markets, and are under direct ECB supervision. By contrast, the roughly 2,500 LSIs (including those in IPSs, as set out in Table 1, and individual bank entities of groups that do not pass the SI thresholds) remain directly supervised by national authorities, with only indirect ECB oversight.

In addition to this key divide between SIs and LSIs, supervisory practice is also differentiated. Under the ECB's original principles, the intensity of supervision should vary in line with a bank's size and complexity (ECB, 2014; Principle 7; supervisory fees also vary). This is only one of several criteria that inform the differentiation in supervision and the ECB's approach to risk-based supervision. For instance, within the Supervisory Review and Examination Process (SREP), the ECB from 2016 engaged with some banks on their management and resolution of non-performing loans (NPLs). However, the application of a detailed guidance document was initially limited to only about 30 banks with what were deemed excessive NPL levels. As in other areas, the specific type of risk, rather than the institution's size, guided this intervention by the ECB.

Notwithstanding the division of responsibilities between the ECB and national authorities, the stated objective is that SIs and LSIs should be supervised according to consistent standards. The ECB has powers to intervene both in the overall policies of national supervisors and in the approach to individual banks. A key objective is to avoid the emergence of divergent standards at euro area and national levels. A common SREP methodology has been developed by the EBA and was first applied to the high-priority LSIs in 2018.

4.2.3. Crisis management

The BRRD in principle foresees that the bail-in of investors could be used as a tool for resolution of any bank. All banks, including the smallest, may therefore in principle be required to have suitable balance sheet structures that allow for an orderly resolution. Accordingly, the BRRD gives resolution authorities wide discretion over which banks are subject to additional requirements for own funds and eligible liabilities (MREL), and the definition of the level of such 'bail-inable' capital. Within the euro area, the Single Resolution Board (SRB) has so far set relatively demanding targets for MREL, which in total could amount to up to 27 percent of risk-weighted assets. National resolution bodies have applied this to a subset of smaller institutions (SRB, 2021).

Once a bank has been deemed failing or likely to fail by its supervisor or resolution authority, the BRRD requires the resolution authority to assess whether the 'public interest' justifies a resolution action, with use of resolution funding if necessary, instead of normal (national) insolvency proceedings. The application of this public-interest concept by the SRB and national resolution authorities continues to evolve. In the euro area, only one fairly large institution, Spain's Banco Popular in 2017, has undergone resolution based on a positive public interest assessment. By contrast, Denmark has taken resolution action (with a positive public-interest assessment) on Kobenhavns Andelsbank, a comparatively tiny bank with assets of around €50 million at the time of failure.

Meeting high MREL requirements could be more problematic for mid-sized and smaller banks, or those in smaller EU capital markets where subordinated debt may not be available. Smaller institutions are likely to rely on deposit funding to a greater degree and often do not raise any wholesale funding. A requirement to raise additional liabilities that are potentially subject to bail-in could therefore prove particularly costly for smaller institutions and may in effect require a drastic change of business model once wholesale funding and investor risk assessments are required. The lack of access to capital markets for smaller banks could also be problematic for funding within a resolution process (Lehmann, 2019).

At present, there is very little transparency on which resolution strategies may apply to individual banks, and how shortfalls in MREL relate to bank size (e.g. Gelpern and Véron, 2019). Restoy (2018a) called for establishing a category of smaller banks which would be systemic and ultimately require a resolution process in the case of failure, but for which the bail-in tool would not be relevant as the necessary MREL would be too costly or too difficult to raise. Transfer strategies (a sale of the business or a bridge bank) could be more suitable for the resolution of smaller and mid-sized banks. The European Commission's ongoing work on the crisis-management framework examines whether the framework for the resolution of smaller and medium banks is adequate, and whether such banks could access sufficient funding in resolution (European Commission, 2021).

4.3. Tailoring in the US

The historical development of the banking sector and banking policy in the United States has been very different to that in the European Union, and the two frameworks are therefore not directly comparable.

In general, the US Congress legislates less frequently on financial services policy than the EU co-legislators, and delegates more rulemaking to specialised federal agencies (regulators and supervisors), over which it exercises frequent scrutiny. The policy framework in force as of 2021 has been largely shaped over the last decade by just two legislative acts, namely the Dodd-Frank Act of 2010 and the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, complemented by numerous agency-issued rules[16].

4.3.1. Licensing and regulation

Banks and credit unions in the US are chartered institutions, meaning that their specific legal form entails authorisation to conduct banking business – unlike in Europe, where bank incorporation and licensing are separate processes. US banks and credit unions may be chartered at either state or federal level, in contrast to the euro-area framework in which the ECB is the sole licensing authority for all banks (and credit unions are collectively negligible). This dual system is the product of US history and has been very resilient over time, though it creates potentially harmful opportunities for regulatory arbitrage (OCC, 2003), as does the duality between banks and credit unions at both the state and

[16] Earlier studies for the European Parliament of prudential arrangements in the US include Mason (2015); Mason *et al* (2019); and Gelpern and Véron (2019).

federal levels. There is no apparent relationship between the chartering level (state or federal) on the one hand, and size or complexity on the other hand. Many smaller banks are federally chartered, and some fairly large banks are state chartered, as illustrated by Table 2 (in which the averages per size brackets are similar between state-chartered and federally-chartered institutions, except for large banks with more than $50bn in assets). As for the smaller credit unions, state-chartered ones are even larger on average than federally-chartered ones.

Table 2: Federally chartered versus state-chartered banks and credit unions.

	Banks				**Credit unions**			
	Federal charter		State charter		Federal charter		State charter	
	Number	Average assets ($bn)	Number	Average assets ($bn)	Number	Average assets ($bn)	Number	Average assets ($bn)
<$500m	689	0.19	2,715	0.19	3,003	0.07	1,545	0.09
$500m - $1bn	156	0.71	560	0.69	148	0.70	136	0.72
$1bn - $3bn	129	1.7	438	1.6	116	1.7	144	1.7
$3bn - $5bn	29	3.9	79	3.8	31	3.7	30	3.8
$5bn - $10bn	24	7.4	80	6.9	17	6.9	21	6.9
$10bn - $20bn	12	14.8	43	14.5	6	12.3	5	12.5
$20bn - $50bn	22	33.1	25	30.5	2	25.2	2	37.1
$50bn - $250bn	19	122.0	17	102.8	1	135.7		
>$250bn	8	1,310.8	5	362.1				
Grand Total	**1,088**	**13.3**	**3,962**	**1.9**	**3,324**	**0.30**	**1,883**	**0.46**

Sources: bank call reports from FFIEC and credit union call reports from NCUA

In general, smaller banks are subject to simpler reporting requirements, though not dramatically so. For example, one key requirement for all US banks is to produce quarterly reports on their financial condition and income, known as 'call reports', which are made available to the public on the FFIEC portal. For banks with less than $1bn in assets, and to a lesser extent for those between $1bn and $5bn (CRS, 2020, page 14), call reports are simpler and less detailed than those of larger banks, but the difference is not massive: in mid-2020, the most detailed version was 91 pages long and contained 27 schedules, while the least detailed version was 65 pages long and contained 19 schedules (CRS, 2020, page 11). For all banks irrespective of size, call reports are collected and published at the same quarterly pace (CRS, 2017, pages 5-6).

Tailoring in the US does not, however, necessarily result in lower prudential requirements for smaller banks, even when motivated by regulatory relief rhetoric. The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 illustrates that. Under its Section 201, banks under $10bn in total assets may be exempted from risk-based capital requirements, but only if they comply with a measure of leverage (the 'Community Bank Leverage Ratio' or CBLR) above a minimum threshold of 9 percent, significantly higher than the general US leverage ratio minimum of 5 percent. Thus, banks that opt for this regime face simpler, but also arguably more demanding capital requirements.

The Volcker Rule, which limits the scope for proprietary trading, is waived for most banks under $10bn of total assets. Very large banks, including G-SIBs, BHCs with consolidated assets above $250bn, and BHCs between $100bn and $250bn subject to specific designation by the Fed, have to comply with additional requirements (largely derived from Basel III) including the Liquidity Coverage Ratio, Net Stable Funding Ratio, and leverage ratio of at least 3% (5% for G-SIBs)[17]. In addition, US G-SIBs are

[17] The Basel leverage ratio is generally referred to in the US as the 'supplementary leverage ratio' (SLR), as it supplements the risk-based capital requirements.

subject to the G-SIB capital surcharge and total loss-absorbing capacity (TLAC) requirements in accordance with the global prudential framework.

The prudential framework for credit unions also involves some size-based tailoring, with *"complex credit unions"* defined as those with over $500m in total assets[18].

4.3.2. Prudential supervision

The US has an altogether more complex prudential supervisory architecture for banks than the euro area, with more authorities involved and less direct correlation between size and supervisory responsibility compared to the SI/LSI divide in the euro area. State-chartered banks are supervised by state supervisors (for example, the New York State Department of Financial Services), whereas federally-chartered banks (also known as 'national banks') are supervised by the Office of the Comptroller of the Currency (OCC), which is part of the US Department of the Treasury. In addition, all state banks that are members of the Federal Reserve System are supervised by one of the 12 regional Federal Reserve Banks, depending on their place of incorporation; the FDIC acts as federal supervisor of state banks that are not Fed members. Topping it all, the FDIC has 'backup' supervisory authority over all banks and can conduct its own examinations[19].

US credit unions are supervised by the National Credit Union Administration (NCUA). Among the GSEs, Fannie Mae, Freddie Mac and the Federal Home Loan Banks are supervised by a separate agency, the Federal Housing Finance Agency (FHFA). Yet another specialist agency, the Farm Credit Administration, supervises the Farm Credit System GSEs including Farmer Mac, AgFirst, AgriBank, Farm Credit Bank of Texas and CoBank.

The intensity of the supervisory programme partly depends on size. A threshold of $3bn in plays a role in the determination of whether full-scope on-site examination occurs on a yearly basis (for larger banks) or every 18 months (for smaller ones; CRS, 2020, pages 9-10).

Under the Dodd-Frank Act of 2010, banks under $10bn in assets are exempted from oversight by the Customer Financial Protection Bureau, a conduct-of-business supervisor hosted by the Federal Reserve Board (CRS, 2017, page 6)[20]. All BHCs with consolidated assets above $250bn, and Fed-designated ones between $100bn (or $50bn for foreign banks) and $250bn, are subject to an enhanced prudential regulation programme by the Federal Reserve, and must perform annual company-run and Fed-run (or 'supervisory') stress tests[21]. The $250bn threshold is also the main determinant of a category of very large banks subject to a so-called 'advanced approaches' framework, including the requirement to develop and use internal models for risk assessment.

Similarly to the ECB, the internal organisation of the Fed's supervision activity is partly determined by size thresholds, with different teams dealing with banks under $10bn in total assets, between $10bn and $100bn, and above $100bn (FRB, 2020). Comparable divisions exist at the OCC and the FDIC.

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[18] See 'NCUA Board Proposes Complex Credit Union Leverage Ratio', 22 July 2021, available at https://www.ncua.gov/newsroom/press-release/2021/ncua-board-proposes-complex-credit-union-leverage-ratio.

[19] The SRB has similar backup authority under the SRM Regulation, but has not opted to exercise it so far (Véron, 2019).

[20] For those banks with under $10bn in assets, the prudential supervisor is also in charge of consumer compliance (CRS, 2020, page 2).

[21] All BHC above $100bn in assets are subject to Fed-run stress tests (CRS 2019). For BHCs with under $700bn in total assets the company-run stress tests may be performed every other year.

4.3.3. Crisis management

In a marked contrast to the euro area, the US crisis management framework is essentially the same for all banks irrespective of size or complexity (Gelpern and Véron, 2019). If a bank no longer meets the conditions of its charter, it is resolved by the FDIC. There is no alternative to 'normal insolvency proceedings', no public-interest test, and no 'no-creditor worse off' principle.

For credit unions, the NCUA administers a similar resolution process to that operated by FDIC for banks. The FHFA has crisis-management authority as 'conservator' over Fannie Mae and Freddie Mac, which was triggered in 2008 and remains in place.

BHCs are non-banks and thus subject to the ordinary bankruptcy framework, including the possibility of reorganisation under Chapter 11 of the US Bankruptcy Code. Nevertheless, Section 165 (d) of the Dodd-Frank Act requires BHCs with consolidated assets above $50bn to prepare every year a 'living will' which is also known as a *"resolution plan"* (CRS, 2017, page 7), describing their strategy for rapid and orderly resolution in the event of material financial distress or failure of the company, and including both public and confidential sections. In this process, the word 'resolution' does not refer to a special resolution regime, but to any actions needed to manage the situation and bring about a satisfactory outcome.

Title II of the Dodd-Frank Act also defines an Orderly Liquidation Authority (OLA), in practice a special resolution regime for BHCs or systemically important non-banks that is managed by the FDIC, like the resolution regime for banks. OLA use, however, is not determined *ex ante* (e.g. involving size thresholds) but only in the event of the crisis, by *ad-hoc* determination of the Secretary of the Treasury. As of September 2021, there have been no cases yet of actual implementation of OLA.

5. POLICY CONSIDERATIONS AND CONCLUSIONS

This paper has sketched a comparison between the euro area and US in terms of banking structures and tailoring of prudential policy. Tailoring is applied in both jurisdictions, though to a greater extent in the United States, especially as regards Basel requirements.

European banking structures, like American ones, are inherited from a long and complex history. Prudential policies have been only one of many factors that have shaped them, and EU-level prudential policies only emerged in the 1990s. The relative scarcity of smaller banks in Europe compared to the US once those in IPSs are duly grouped, as detailed in section 2, largely predates the implementation of the successive Basel accords. Banking sectors have further consolidated in the past three decades, but this has been mostly driven by factors such as financial crises and national policies aimed at creating banking champions, as opposed to prudential policies *per se*.

We do not attempt to judge whether the euro area has too few stand-alone LSIs, or the US too many small banks and credit unions. The existence in the euro area of large cooperative groups and IPSs complicates that issue, since their decentralised operational structures allow them to play some of the roles played by smaller banks in the US.

Since the 1990s, the application of the Basel framework to all banks in the EU, a key difference with the US, has been justified by the objective of creating an internal European market for banking services and establishing a level playing field. This objective has, if anything, become more relevant with the initiation of banking union since 2012 and the prominence of cross-border integration as a banking policy objective. In our view, the rationale for universal application of the Basel standard remains valid in the EU and especially in the euro area, given how it remains highly fragmented across national boundaries, and simultaneously overbanked, with insufficient overall banking-sector profitability and competitiveness.

We see no clear case for a reconsideration of the current application of tailoring in the EU banking framework for licensing, prudential regulation and supervision. In the area of crisis management and resolution, by contrast, we view the current tailoring concept in resolution, based as it is on the ill-defined public-interest test, as problematic. We would advocate consideration of a unitary crisis management and deposit insurance framework along the lines of what exists in the US under the FDIC's authority (see Gelpern and Véron, 2019).

Even under the most optimistic assumptions, it will be many years before the euro area is sufficiently integrated across national boundaries and structural profitability problems are addressed. Until then, a fairly broad application of prudential policies with only limited tailoring seems justified. Policies that favour entry by new institutions, including in fintech, and the adoption of digital technologies, could further support the objectives of competitiveness and integration.

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All jurisdictions tailor their prudential policies to bank size, with generally more complex —though not necessarily more stringent—requirements for larger banks. This paper compares such policies in the euro area and United States, in the context of the differences in banking system structures and legal frameworks. There are vastly more stand-alone smaller banks and credit unions in the US than in the euro area. The US approach to prudential requirements is generally more differentiated by bank size than the euro area's, but the US has a more uniform framework for bank crisis management and resolution. Given the permanence of cross-border fragmentation and overbanking in the euro area, further size-based policy differentiation would be ill-advised.
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