

# Market integration, harmonization and Basel IV

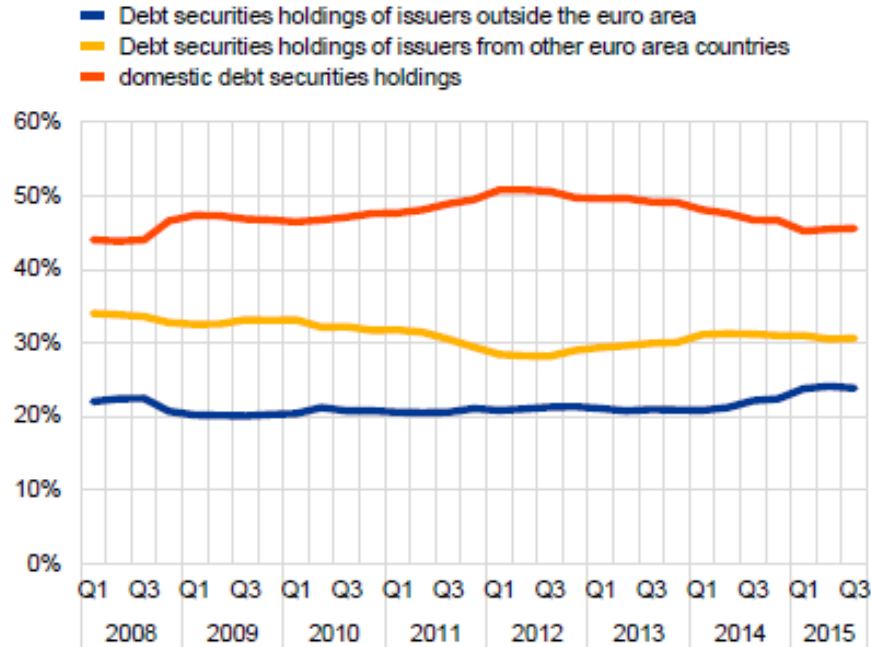
*Jakob Kongsgaard Olsson*

Head of Department, Finance Denmark

# Financial market integration is significant...

Holdings by euro area investors (all sectors) of debt securities

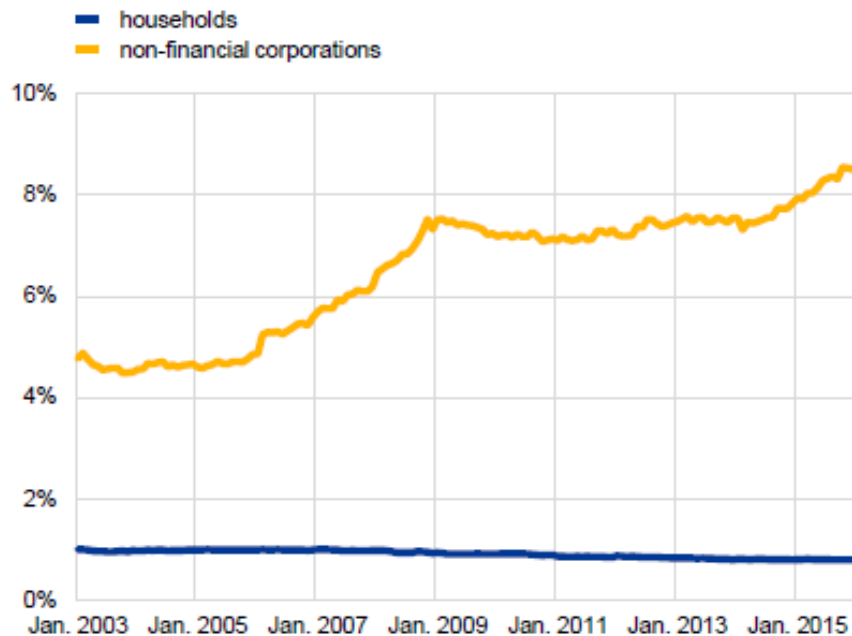
(percentage of total holdings)



# ....and outweighs integration in loan markets..

Share of cross-border loans in the euro area by sector

(percentages per annum)

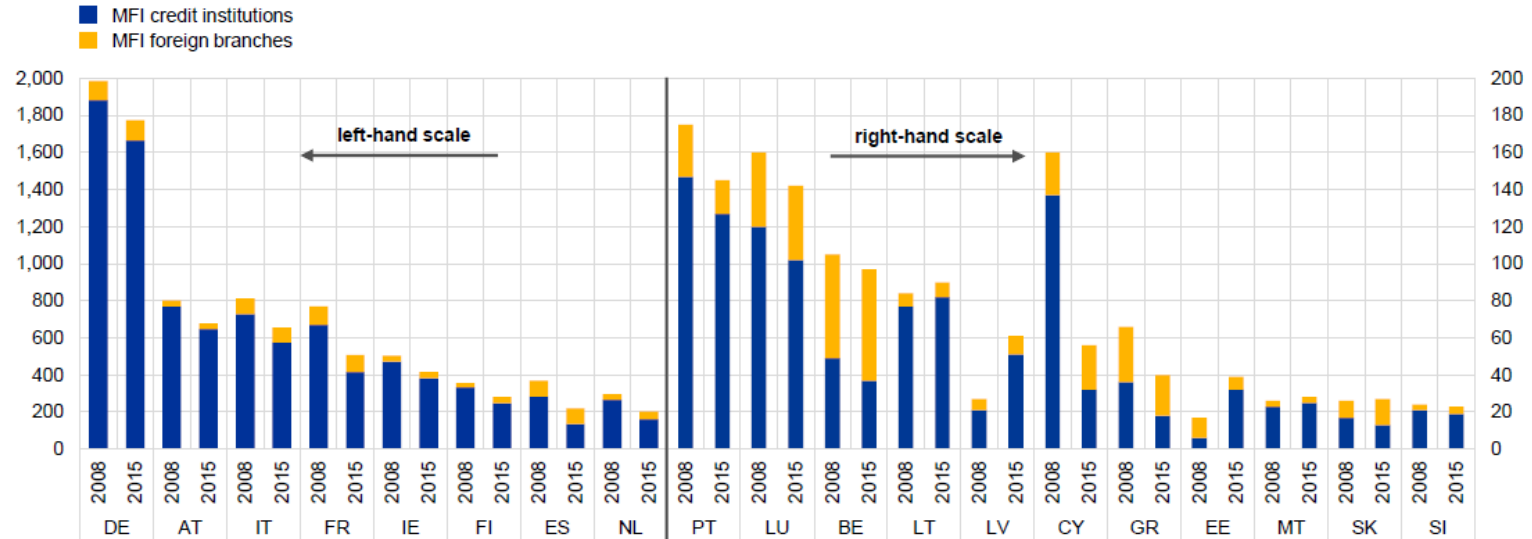


Source: ECB (BSI statistics).

Notes: Cross-border loans include loans to other euro area countries for all maturities and currencies. Interbank loans do not include central bank loans.

# ..which measured by foreign branches are extremely low

Number of credit institutions and foreign branches in 2008 and 2015



Source: ECB (MFI statistics).

Note: Figures for Latvia include credit unions starting from 2013.

# Regulatory harmonization has fostered financial integration...

Example:

- The definition of covered bonds has been tightened continually.
- Covered bonds have become a brand known for its high level of security and quality.
- An integrated framework for covered bonds is part of the Capital Market Union Action Plan.



By Ken Teegardin

# ...however it does not necessarily work....

- Harmonization of rules does not by it self lead to a larger geographical market (1).

## Possible barriers to market integration:

- National preferences
- Regulatory barriers
- Distribution cost



(1) The internal market and the relevant geographical market The impact of the completion of the Single Market Program on the definition of the geographical market, Final report, 03 February 2003, Copenhagen Economics

## ...and harmonization could harm competition

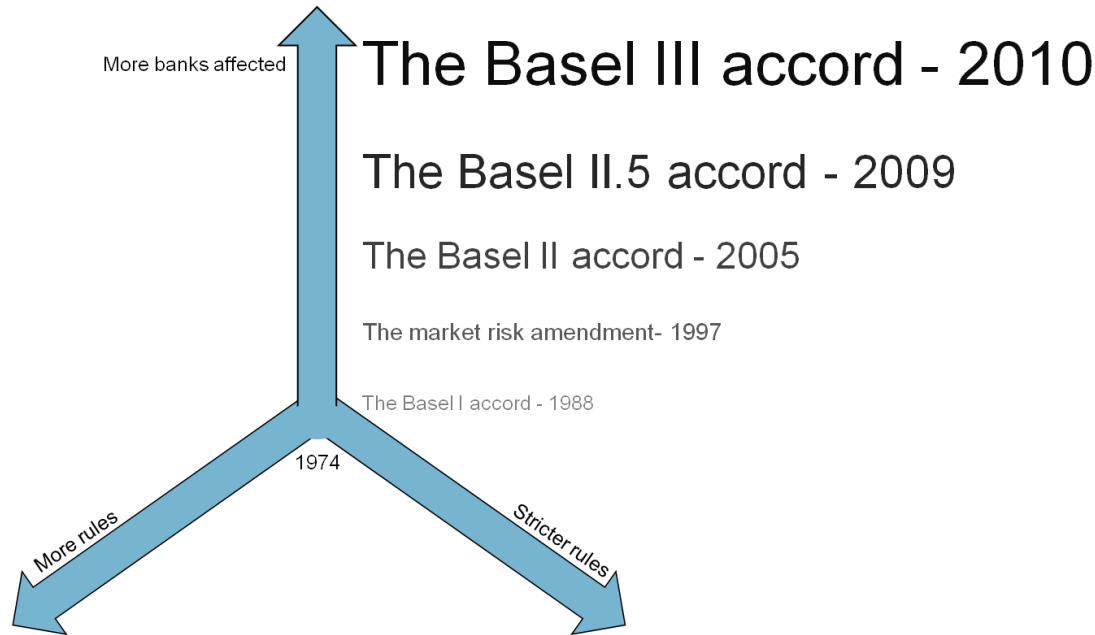
- Harmonization can lead to less diversity because suppliers that diverge could be forced out of the market:

*"The forced uniformity that harmonization would bring would mean too great loss of diversity and of valuable adoptions to local conditions. Also, even if uniformity at the proper regulatory standard would be better than the local diversity, the risk that a forced harmonization would occur at an inappropriate regulatory standard is too great."*

Source: Lawrence J. White, "Competition versus Harmonization - An Overview of International Regulation" page 5-48 (Barfield, v. 1996); R.van den Bergh, Regulatory Competition or Harmonization of Laws – page 30.

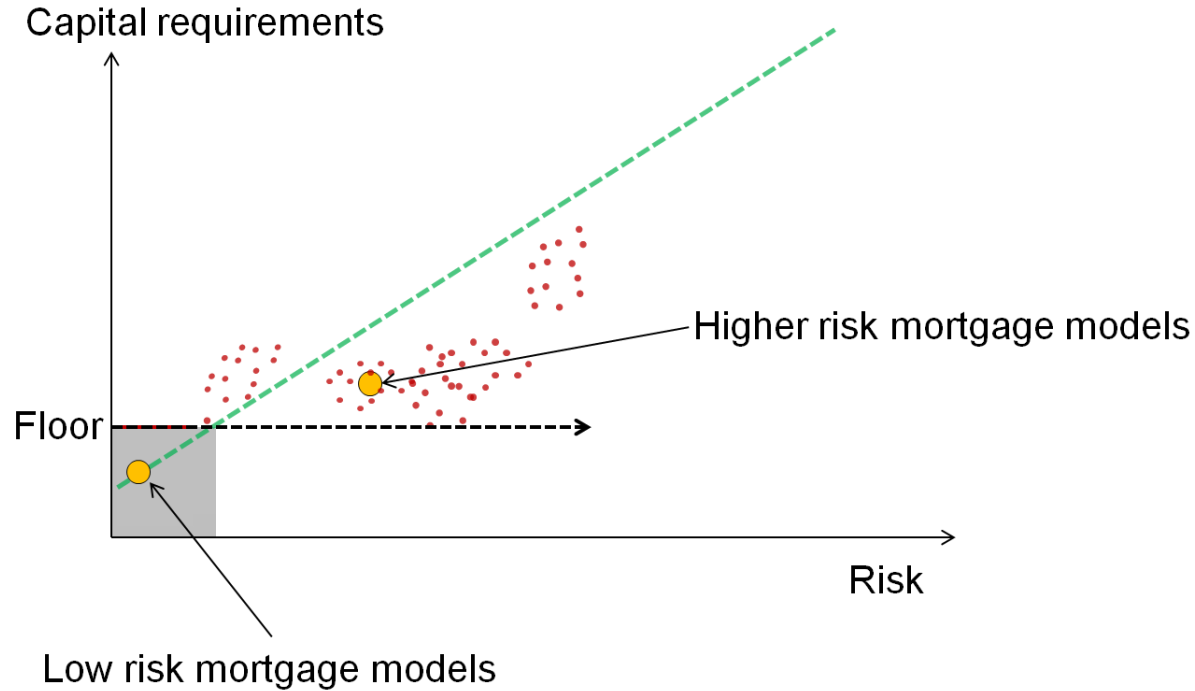
# There is a risk that rules from the Basel Committee could squeeze business models<sup>4</sup>

## Evolution of the Basel Committee





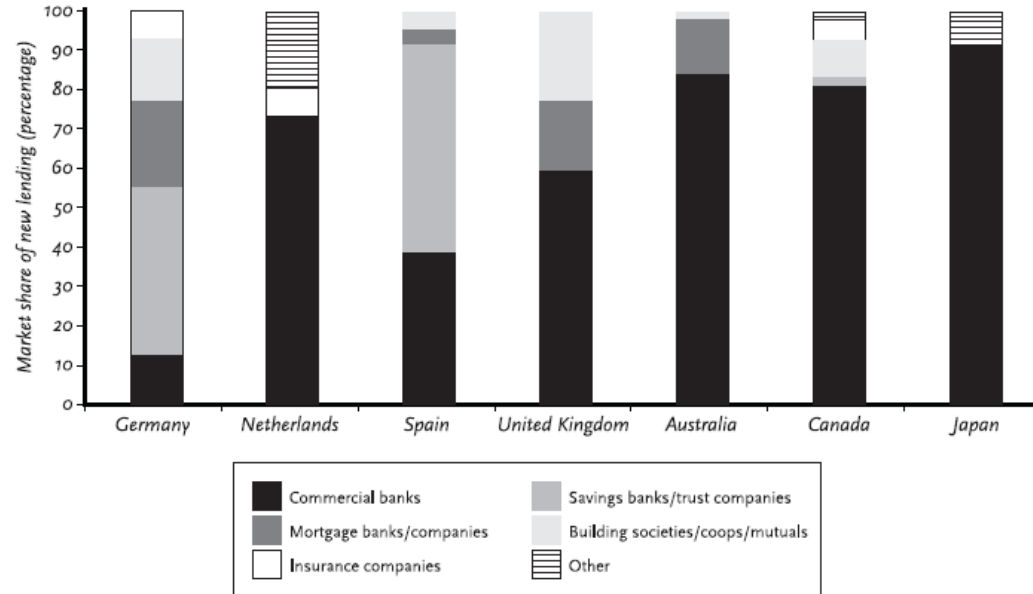
# Illustration of capital floors



# It is important to leave room for low risk business models...

- In Denmark the loan-splitting (1) housing finance model is at risk with the capital/risk floors suggested by Basel IV
- Other low risk models around the world face the same risk

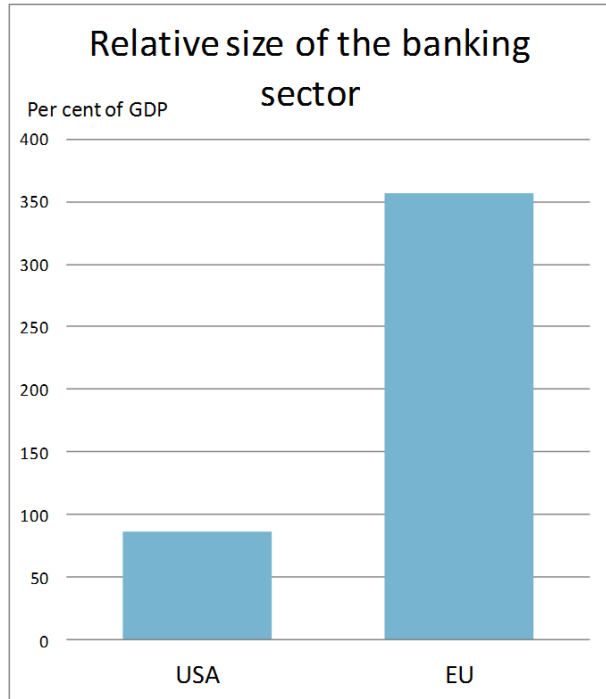
Mortgage lenders by type



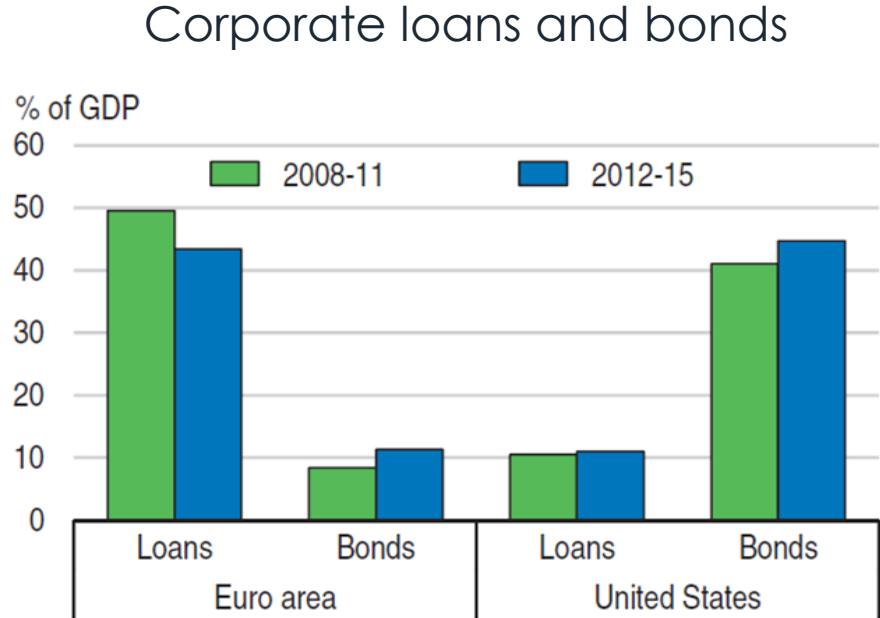
(1) One loan is granted by the mortgage bank covering up till 80% for residential lending (60% for commercial lending) – the inner collateral  
Another by a universal bank covering the remaining part – the outer (top-up) collateral

Source: *Housing finance policy in emerging markets*, IMF

# ...and keep different structures in mind



Source: Danish FSA, April 2016



Source: Eurostat, ECB, US BEA, Federal Reserve and SIFMA.