Discussion of:

International Portfolio Frictions

by

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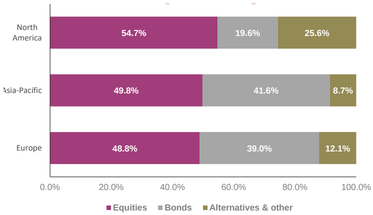
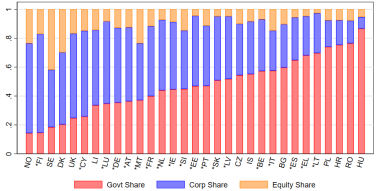
This Paper

- Stylized facts on asset allocation by European insurers and banks.
- Overall portfolio:
  - Higher weight on corporate relative to government bonds in countries where insurance and pension fund sector is larger.
  - In those countries, corporate bond market is larger and government bond yields are lower.
- International diversification:
  - Higher weight on corporate relative to government bonds in domestic portfolio $\rightarrow$ Higher weight in international portfolio. (Domestic projection bias)
  - Portfolio of a foreign subsidiary resembles that of domestic firms in country where subsidiary operates. (Going native bias)
- Propose some explanations based on a simple model.

Comments

- Stylized facts are new and important.
  - New dataset.
  - Implications for European capital market integration (CMU), growth, risksharing and financial stability, and financial regulation.
- Useful to dig deeper into the stylized facts and the underlying mechanisms (in this or subsequent papers).
- Remainder of discussion: Implications of and explanations for the stylized facts that complement those in the paper.





Source: Thinking Ahead Institute "The World's Largest Pension Funds 2022" and Figure 1 of this paper

- Pension funds allocate significantly more to equity than insurers in this paper's sample.
    - Life vs. non-life insurers?
- Are pension funds similar to insurers in the other dimensions studied in this paper?

Government vs. Corporate Bonds

- Model: Insurers hold corporate bonds only when households and asset managers do not hold government bonds.
  - Intuition: Government bonds are more attractive to insurers than to households and asset managers because of capital regulation.
  - Clean but extreme result: why do both insurers and asset managers hold government bonds?
- Implication: Spread between corporate and government yields should be larger in countries where insurance and pension fund sector is larger.
  - Is this true? Extend Greenwood & Vissing-Jorgensen (2018)?

Domestic Projection Bias

- Domestic projection bias could reflect geographical patterns of foreign investment.
  - Suppose that insurers' foreign investment is into neighboring countries.
  - Danish insurers diversify into Sweden, Norway, Finland, Germany and UK $\rightarrow$ Their international portfolio gives high weight to corporate bonds because corporate bond markets in those countries are large and relatively low-risk.
  - Greek insurers diversify into Italy $\rightarrow$ Their international portfolio gives high weight to government bonds.

- Describe network of international holdings.
  - Is foreign investment into neighboring countries?
  - Is foreign investment into large countries/markets?

Going Native Bias

- Going native bias could reflect differences across national regulators.
- It could also reflect relative-performance evaluation or herding.
  - Foreign subsidiaries are evaluated relative to other firms in the market where they operate.
  - Relative-performance evaluation can give rise to herding.

Broader Implications

- European capital market integration (Capital Markets Union) is limited.
  - Segmentation that this paper documents holds also for equities. Percentage of insurers' equity investment in home firms is 80% in France, 70-75% in Germany, the Netherlands and Austria, and 60% in Spain.

    Source: https://www.imf.org/en/News/Articles/2019/06/25/sp061419-on-capital-market-finance-in-europe
  - Implications for growth, innovation, convergence between countries, risksharing.
  - Describing network of international holdings can provide better understanding of frictions and policies to mitigate them.
- Regulation of insurers, banks and pension funds creates high demand for government bonds that outstrips supply.
  - Is regulation-driven demand excessively high?
  - How to foster growth of new firms?