INTERNATIONAL PORTFOLIO FRICTIONS

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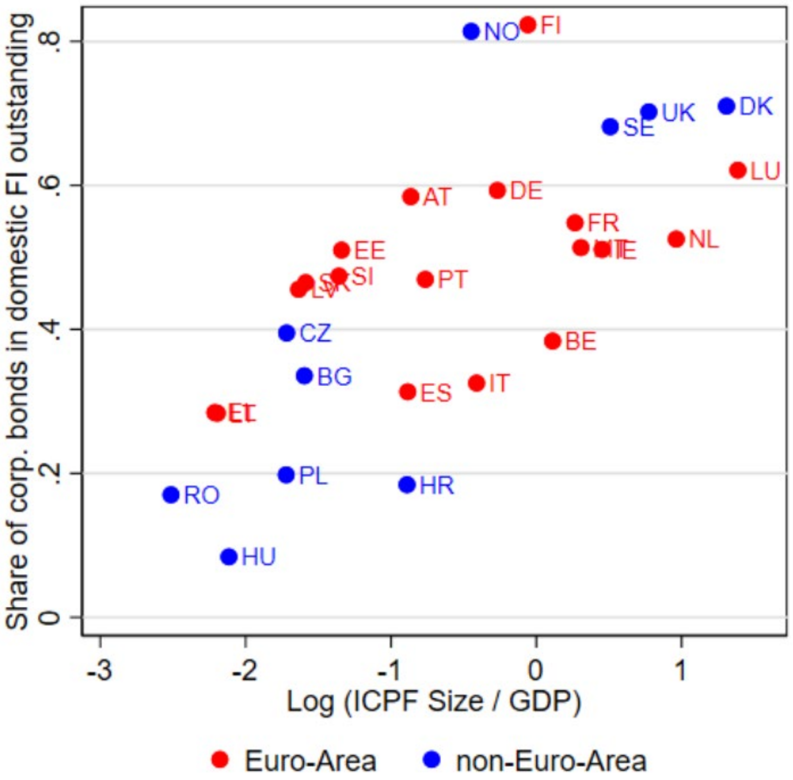
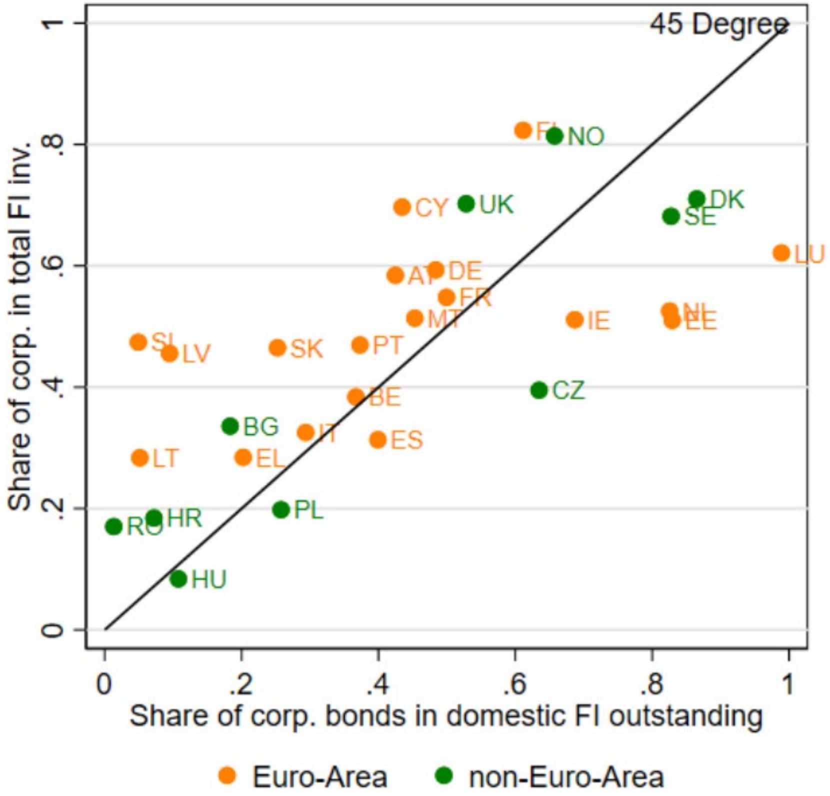
Structure of the Paper

- Use data from regulatory filings to establish some high-level stylized facts about the composition of the portfolios held by insurance companies, pension funds, and banks in different European countries
- Composition measures are based on banks and insurance companies
- Aggregate statistics also include information on pension funds
- Except for Table 3, results in the paper are at the pooled country level
- Still much opportunity to use other dimensions of the data
  - Time-series dimensions
  - Insurance-company level
  - Euro vs. Non-euro and whether integration looks different within currency
  - Equity vs. Fixed Income choice
- I am going to use my time to focus on three of the observations made by the paper

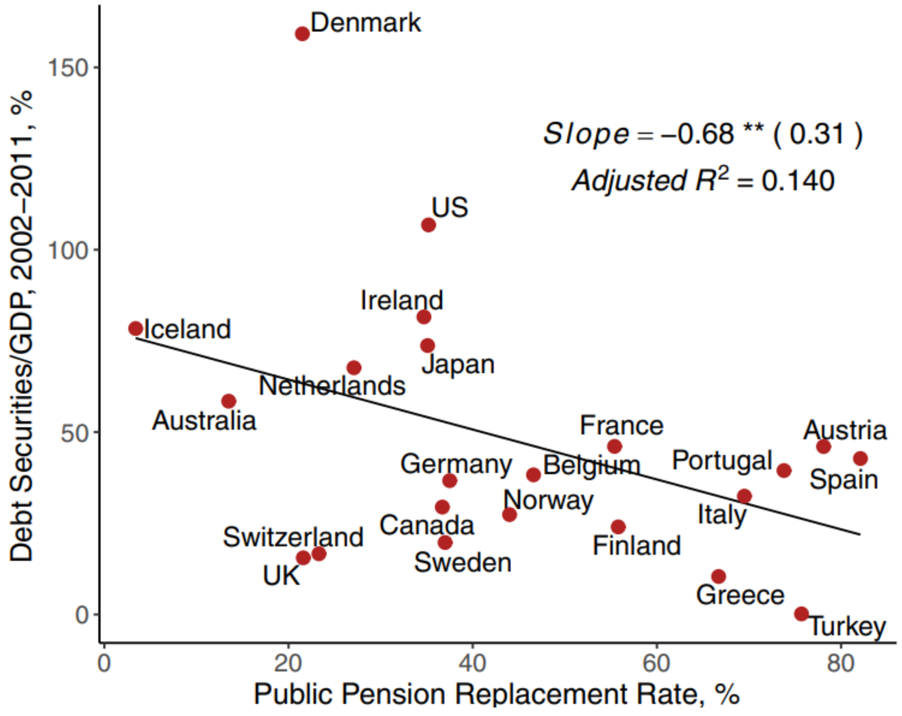
Fact 1: Market structure

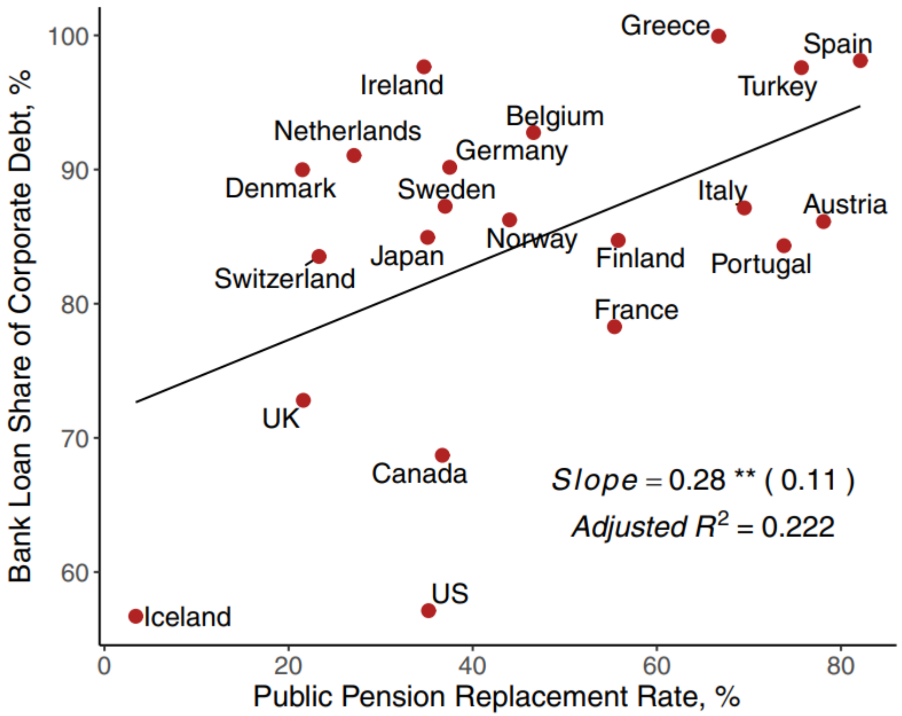
- Large ICPF → More Corporate Bonds → More Corporate Bonds held by Insurance Cos. in Portfolios
- First link is reminiscent of Scharfstein (2018)
- Minor comments: Value weighted? Euro vs. Non-euro?





PRIOR RELATED EVIDENCE



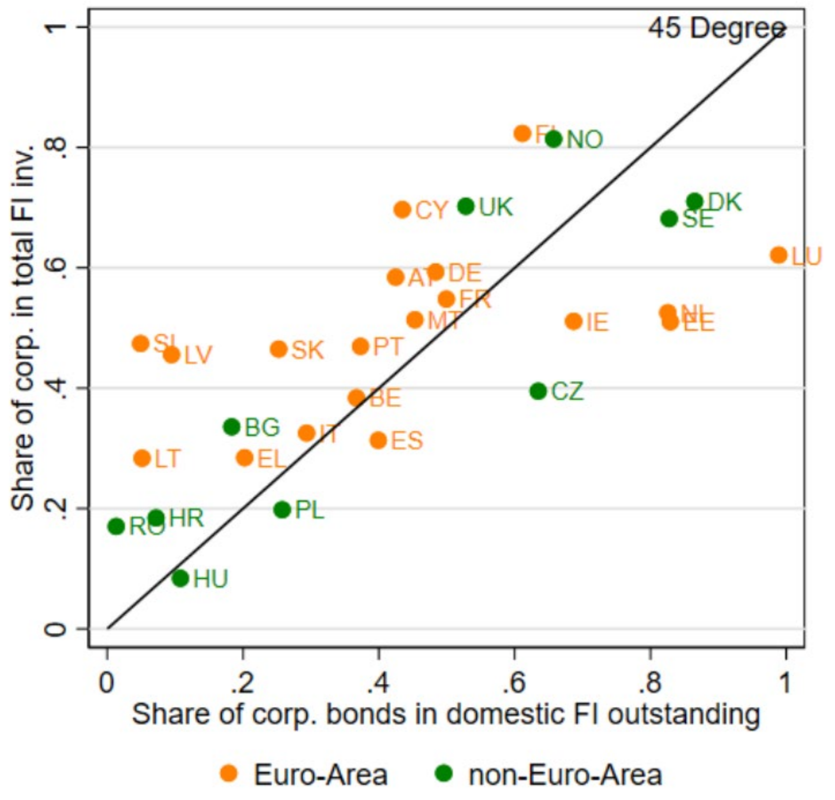


Source:
Scharfstein (2018)

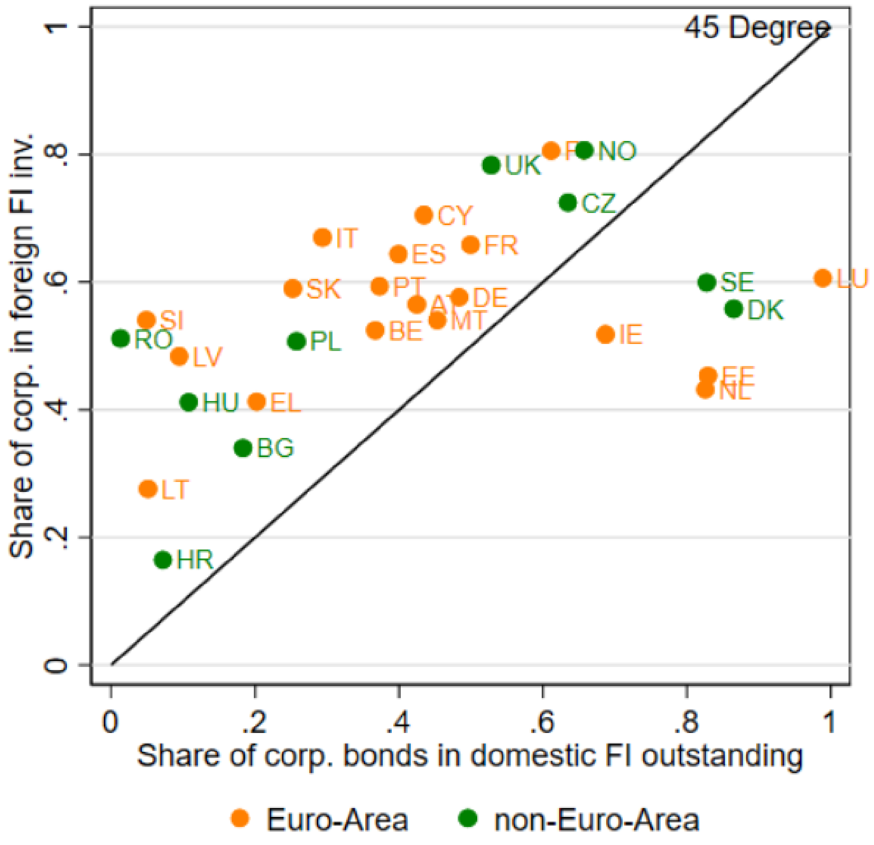
- Together with prior evidence, raises the question of what is causal here?
- Intriguing argument that structure of pension and insurance industry drives capital market and portfolio allocations
- Is this pensions or insurance? Does it matter?
- More micro evidence on financial system -> capital market deepening
- When Norway experiences high oil price returns, do Norwegian companies issue more bonds?

FACT 2

- "Domestic Projection Bias"



(b) Foreign Investments



Even in their foreign investments, insurance cos. Operating in markets with lots of corporate bonds, tend to own corporate bonds abroad

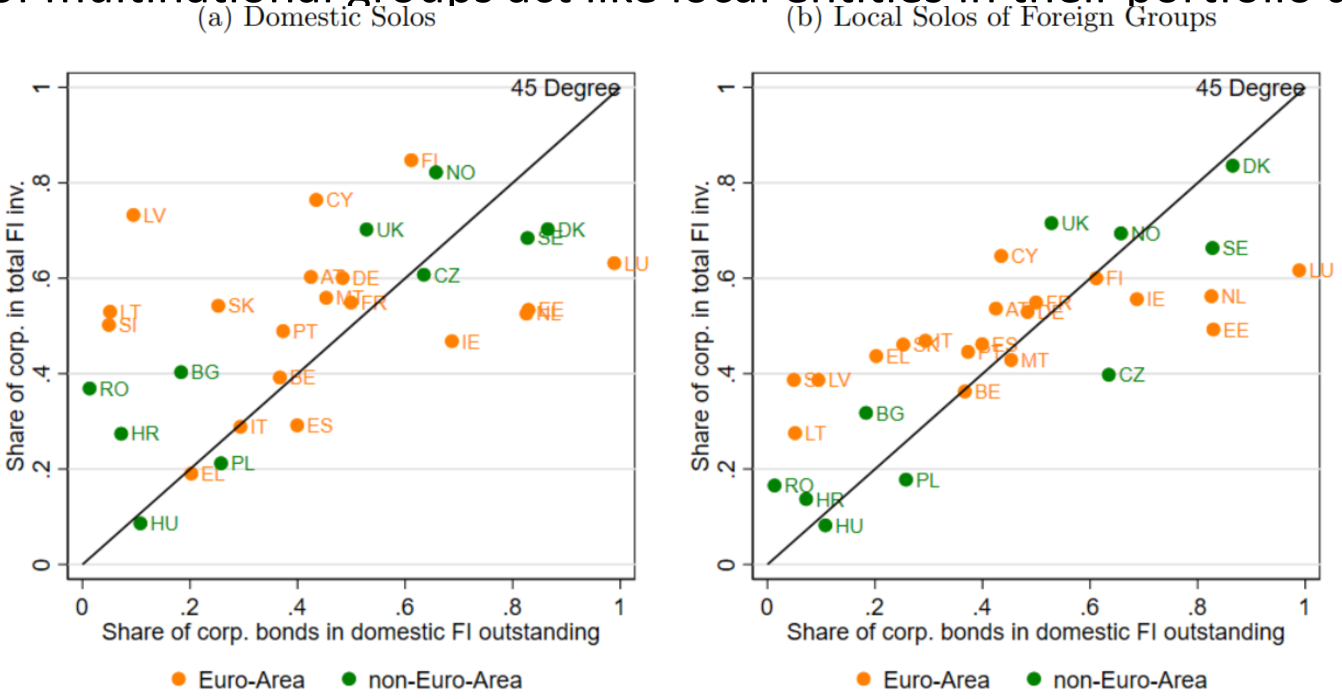
Domestic Projection bias

- This result seems to be
  - sensitive to one or two data points
  - substantially weaker within the eurozone
- Still, it's potentially interesting given a null hypothesis that the sign should be the opposite direction
  - If you take on more corporate bond risk domestically, in principle portfolio optimization should have you take on less such risk abroad

- Unclear whether this "bias" is really just a tilting towards a few countries with other characteristics
  - Could control for credit risk or CDS in Table 2
- One potential story is that this is driven by product market competition:
  - Financial products in a given country have a target return driven by the mix of securities in the domestic market
  - This causes similar mixing in other markets
- Use of the word "bias" makes it sound like it's a behavioral attribute rather than driven by some underlying incentive

FACT 3: GOING NATIVE BIAS

- Subsidiaries of multinational groups act like local entities in their portfolio allocation decisions



- *"When "foreign firms" operate in local markets, they behave as if they were "domestic firms" and their portfolios strongly track the domestic supply of corporate versus government bonds. We refer to this behavior as the "going native bias," i.e., the fact that local subsidiaries of foreign multinational inherit the portfolio bias of domestic firms as a function of domestic characteristics. The similarity between local and foreign firms undermines several traditional hypotheses in explaining portfolio home bias, such as information asymmetries, lack of investment expertise in international markets, and behavioral reasons that lead to more optimistic beliefs about domestic assets."*

Going Native Bias

- Main idea: subs tend to "copy" asset mix of local competitors rather than to do asset allocation based on the home office
- Analogy: Becker (2007): In the US, areas with a higher share of seniors have more deposits. Using this as an instrument, he shows that more bank funding is associated with stronger lending, more capital-intensive economic activity locally. Effect has faded with the geographical integration of US commercial banking.
- Comments:
  - Would be cleaner to do this analysis in changes, i.e., to plot asset allocation expressed as a deviation from the home office
  - This will help rule out composition-type effects, that you tend to operate local offices in countries that are similar to you (and perhaps have more developed markets)
  - The authors put forth argument that this could be coming because of old habits dying hard, but an alternative is that it's driven by product market competition

OTHER COMMENTS

- There is a perspective in the paper that lots of variation in portfolio shares represents a limitation of regulation
  - Glass half full? If the regulation is only supposed to bind at the edges, then variation might be good
  - Some calculations on how binding the insurance regs are would be helpful
- Pensions vs. Insurance?
- In general, little information in the paper about the underlying products sold by the insurance companies and whether that mix matters
- How much can be made of variation between insurance companies in the same country?
- An area of the paper that feels underexplored is the distinction between euro and non-euro countries, and whether a common currency facilitates capital market integration
- Most of the calculations of the paper are value weighted (i.e., adding up the dollars) at the country level, but then cross-country comparisons are equal weighted
- Allocations to equities are in the background, but should be explored further

- **Overall: a fascinating paper that raises lots of questions and suggests follow-on work**