RESEARCH

International Portfolio Frictions

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General Comments

- I liked the paper very much. I recommend it to anybody interested in these issues:
  - Very-well written, crystal-clear
  - Unique and amazing dataset
  - Novel findings on investment behavior of European banks and insurers
  - Policy relevant implications
- Suggestions for further work:
  - Explore both side of balance sheet
  - Role of geography and ER
  - Consider alternative explanations for the evidence

Summary of Results

1. Heterogenous portfolio allocation across countries (corporate bonds vs sovx bonds vs equities)
2. Portfolios tend to reflect home country's financial markets
3. Insurers and banks replicate domestic portfolio composition in their foreign holdings, **"*Domestic projection bias*"**
4. Local subsidiaries of foreign firms behave like local firms, **"*Going native bias"***
5. Firms in countries with high sovereign yields hold more sovereign bonds…
6. …and they choose similar high yield bonds for their foreign portfolios

A Crowding-Out Driven Story?

- Countries with higher Debt/GDP ratios tend to have higher yields
  - Crowd out private sector issuances
  - Increase cost of capital for insurers and banks
- Portfolio response:
  - Invest in high yield sovx bonds rather than corporate
  - Search for yield in foreign investment

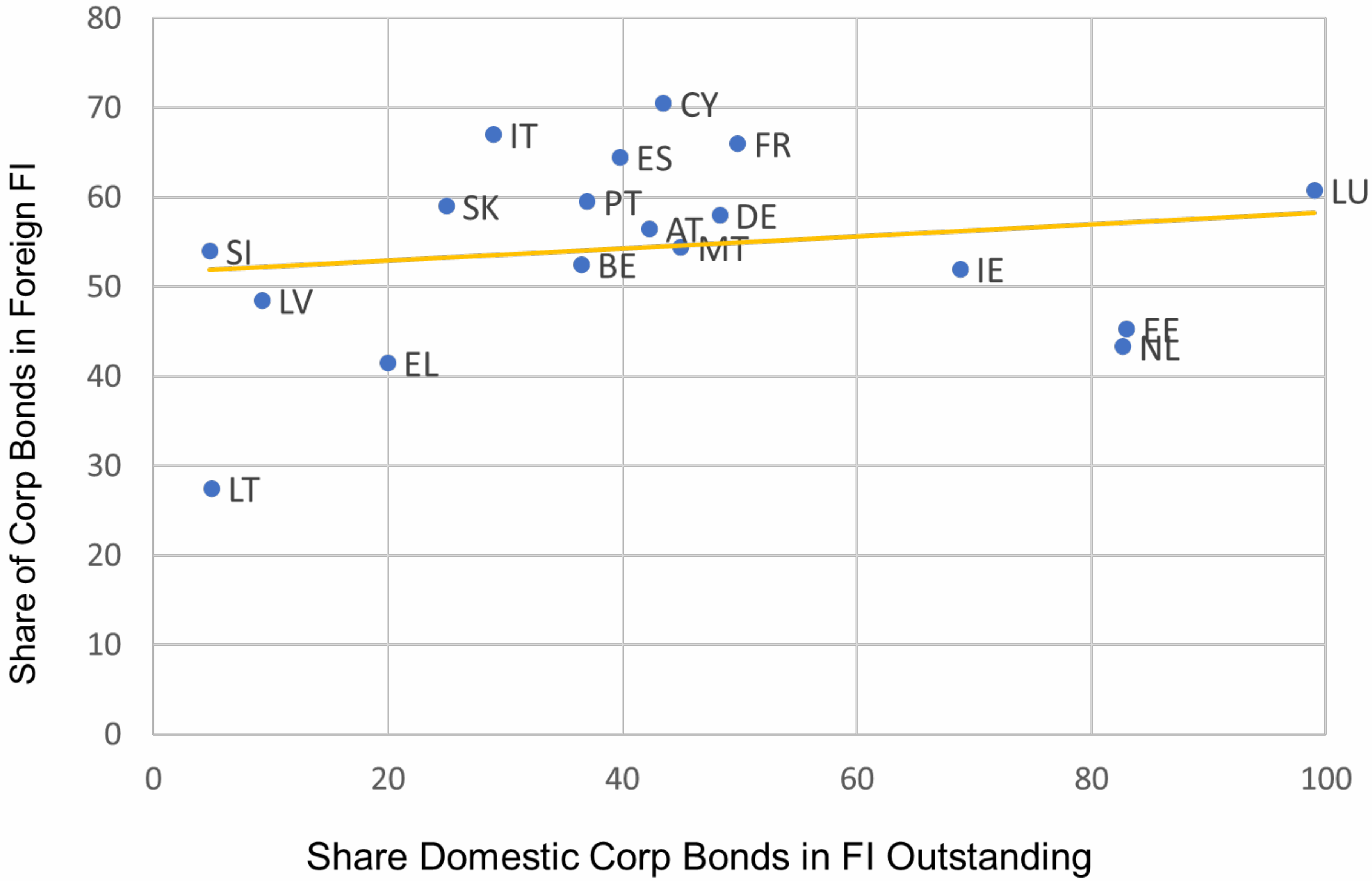
A Liability-Side Story?

- “*Domestic projection bias*” + “*Going native bias” suggest a domestic yield constraint*
- Domestic market conditions may shape competition among providers
- Higher yields may lead to more generous benefits or higher costs
- All under an umbrella of potential risk shifting
- → Explore liability side by country:
  - Do firms in high yield countries have higher profits? If not, do they offer more generous products? Do they pay more for their inputs (wages, debt, etc.)?

Does Geography Matter?

- EA seems to matter. Is it regulation?

Domestic Projection Bias Less Visible in EA



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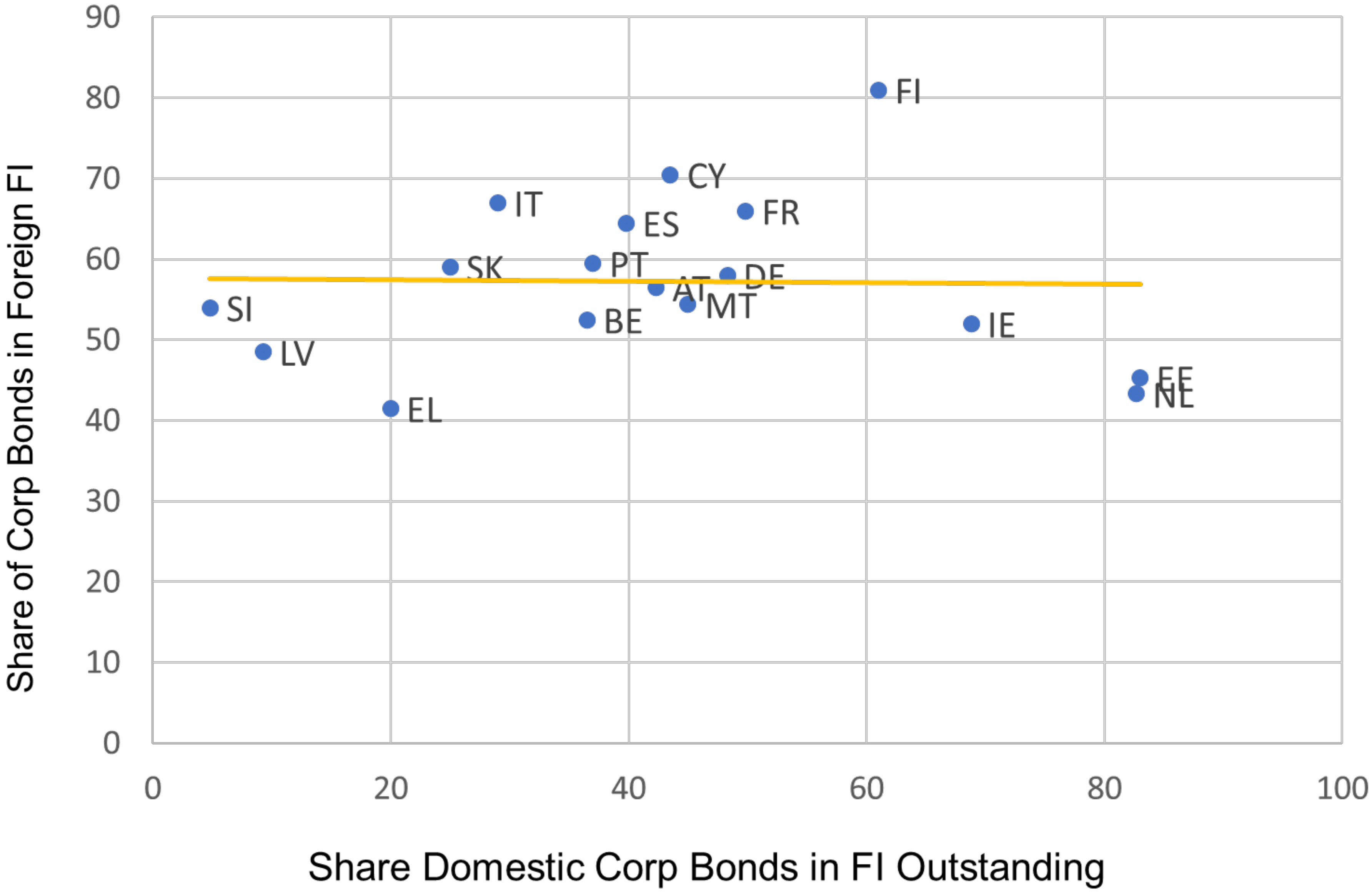

Does Geography Matter?

- EA seems to matter. Is it regulation?
- Make greater use of very granular data:
  - Cycle correlation (maximize or minimize portfolio risk?)
  - Information flows (invest in neighboring and similar countries?)
  - Cross-border corporate presence (follow other sectors?)
- Potential role of ER and inflation exposures

Thank you