Discussion of "International Portfolio Frictions" by Du, Fontana, Jakubik, Koijen, and Shin

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Main results

- The paper studies the fixed-income portfolios of European insurance companies and banks over 2016-2021
- Sovereign/corporate bond mix by insurers and banks very heterogeneous across countries
- Yet highly homogeneous cross-border investment strategies:
  - For a given firm, the mix does not vary across asset locations
  - For a given country, the mix does not vary across firms no matter the ownership

Comments

1. Real estate and derivatives?
2. Controlling for insurance liabilities
3. Scarce supply of safe assets, really?
4. Are insurers as good "hostages" as bankers?
5. Correlation with central banks' portfolios

1. Real estate and derivatives

- Could we have a sense of the size and composition of positions in derivatives (interest rate, credit, FX)?
- Real estate is an important asset class for insurers often with a specific dedicated management. Could you isolate it? Right now, split between equity (directly held) and corporate bonds (real-estate backed securities)
- Heterogeneous organizations of real estate markets may affect this split

2. Controlling for insurance liabilities

- The insurance sector is legally unified but economically very diverse/much more so than banking
  - Life: Stocks of contracts with different guarantees/options/fiscal costs of exercizing them (admittedly hard to observe in these datasets).
  - Non life: business lines with varying volatilities (reinsurance/corporate vs households) and duration (measurable with technical reserves over premia ratio)

Which fraction of the heterogeneity in assets could be due to the resulting heterogeneity in the risk profiles of insurance liabilities?

3. Scarcity of safe assets in Europe, really?

- The paper seems at times to make normative statements on an insufficient supply of (nominally) risk-free assets: *"Despite favorable regulatory treatments for banks and insurers, the reality is that there are not enough government bonds outstanding relative to the size of ICPF sector and banks' securities portfolio in Europe."*
- Maybe so (although more than ever before) but this point cannot be made only from the viewpoint of FIs management
- Also, FI's demand for sovereigns is spurred by a prudential regulation that can be viewed as a form of financial repression: heavily subsidized sovereign exposures no matter the economic risk
- Maybe it is a good thing—but what is the market failure that motivates it?

4. Are insurers as good hostages as bankers?

Link to "Sovereign Default, Domestic Banks, and Financial Institutions" Gennaioli et al (*JF*, 2019)

- "Banks as hostages" theory of sovereign debt: Sovereign debt repayment credible because (non selective) default hurts FIs and thus growth.
- "In line with these findings, the data also show that the probability of public default is lower in countries where financial institutions are stronger, where intermediaries hold more public debt, and where capital inflows are larger"
  1. Would be interesting to compare with your results
  2. The financial distress of insurers is (I think) way less costly for short-term growth than that of banks and yet they have as much sovereign: I think that your results challenge this hostage theory

5. Correlation with central banks' portfolios

I would like to see how the securities' holdings of each country's CB (often but not always part of the eurosystem) correlates with that of the FIs:

1. Banks have been able to swap bonds for reserves over the period, not insurers. Do you count claims on CBs as government bonds? Should you?
2. Financial/fiscal dominance: Monetary tightening may threaten private and public borrowers, and so the CB may take more risk on its balance sheet than price stability warrants. Do we see anything consistent with this?