International Portfolio Frictions

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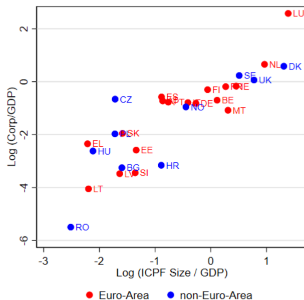
Motivation and Findings

- Research question: What drives the global asset allocations of banks and insurance companies? This is a key question to understand:
  1. Development of financial markets.
  2. Integration of the European financial market.
  3. Cross-sectional spillovers across sectors.
- Authors tackle this important question using regulatory data based on Solvency II and BIS Locational Banking Statistics. Amazing data collection efforts!
- First observation: Countries with a large ICPF sector tend to have a large corporate bond market (government bonds are insufficient).
- Two new facts about international portfolio frictions:
  - Domestic projection bias: Insurers and banks do not offset features of the domestic markets in their investments abroad.
  - Going native bias: Multinational groups act like local entities.

Another possible channel: Can geographic proximity explain the domestic projection bias?

- The low (high) interest rate countries are geographically closer to one another.
- Hence, geographic proximity may explain similar sovereign credit risk in the domestic versus foreign portfolios.
- In addition, the low (high) interest rate countries also have larger (smaller) corporate bond markets.

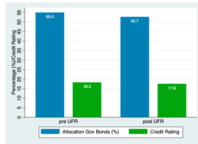


What can we learn about the root causes using the institutional security-level data?

- The previous point is one example of an alternative channel.
- Perhaps low (high) interest rate countries also have longer (shorter) durations of their liabilities. If the outstanding corporate bonds have longer durations than the government bonds, a duration channel may also be at play.
- In sum, how can we distinguish between the various channels to explain the domestic projection (and going native) bias?
- Security-level data at the institutional level would be very helpful here! Allows to control for balance-sheet considerations and bond characteristics.

Are international portfolio frictions undesirable?

- Insurance companies behave more alike after implementation of Solvency II (*Source*: Jansen 2024).
  - Implementation of the UFR coincides with implementation of Solvency II.



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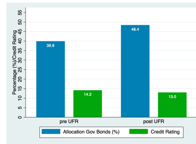
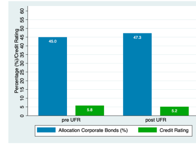


(b) Historical Costs

Government Bonds



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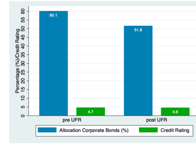

(d) Historical Costs

Corporate Bonds

- If insurance companies follow the same strategies, this may create financial fragility in the financial system.
- So, the heterogeneity across countries uncovered here may not be undesirable from a systemic risk perspective.

Conclusion

- Super important question with novel regulatory data - highly recommend it!
- Key policy implications for European market integration, capital market deepening, and spillover effects across sectors.
- I encourage the authors to dig deeper into the root causes of the empirical facts.