The fire-sale channels of universal banks...

Discussion at PWC Conference.

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Overview

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- This paper: banks allegedly sold high-risk Euro bonds to affiliated mutual funds and households as a de-risking strategy during the crisis.
  - Abstract: "Our findings..suggest..a severe conflict of interest between banks..and the..wealth management services they offer to retail investors..calling for better consumer protection."

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  - The latter correlation is what the paper focuses on.

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- In section 7, the paper turns to a broader sample – of funds that are both affiliated and unaffiliated.
    - Table 16 shows that the correlation becomes weaker (insignificant in some specifications) for this sample.
    - Paper then resorts to (less precise) cross-sectional specifications to provide more evidence.

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  - Null hypothesis is clearly not zero correlation of changes across bank and fund/investor portfolios given many unobservables (news, portfolio constraints).

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- The paper has 27 tables and 7 figures. I would substantially shrink this set, as the central points that the paper makes can be condensed to just a few tables and figures.
    - Otherwise it distracts the reader from the central result.

Comments - II

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- Changes occurring inside the quarter are opaque, and therefore, so is intra-quarter timing.
  - Cannot condition on counterparty trading responses to price movements within the quarter. At the quarterly level, the fixed effects will help, but this is not the entire story given frequent news releases over this period.

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- Reductions in holdings of 100MM Euros by banks are associated with increases of roughly 1% of that amount (1 MM) by affiliated funds, and 40 bp of that amount (400k) for households.

- Is this really meaningful? How should we think about this?

- Raises the possibility that what the authors might be picking up is contrarian behaviour by mutual funds and retail investors – more on this next.

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- Regulatory pressure on banks to get out of risky bonds creates opportunities for less constrained investors to purchase these bonds at a discount.
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- Regulatory pressure on banks to get out of risky bonds creates opportunities for less constrained investors to purchase these bonds at a discount.
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  - Need to look at post-crisis performance on these transactions to figure this out.
- Authors point to this mechanism briefly in the literature review. Better to give it equal billing; difficult given data to distinguish between these explanations.

Conclusions

- Interesting paper, food for thought.
- I look forward to seeing future versions!
- All the best.

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