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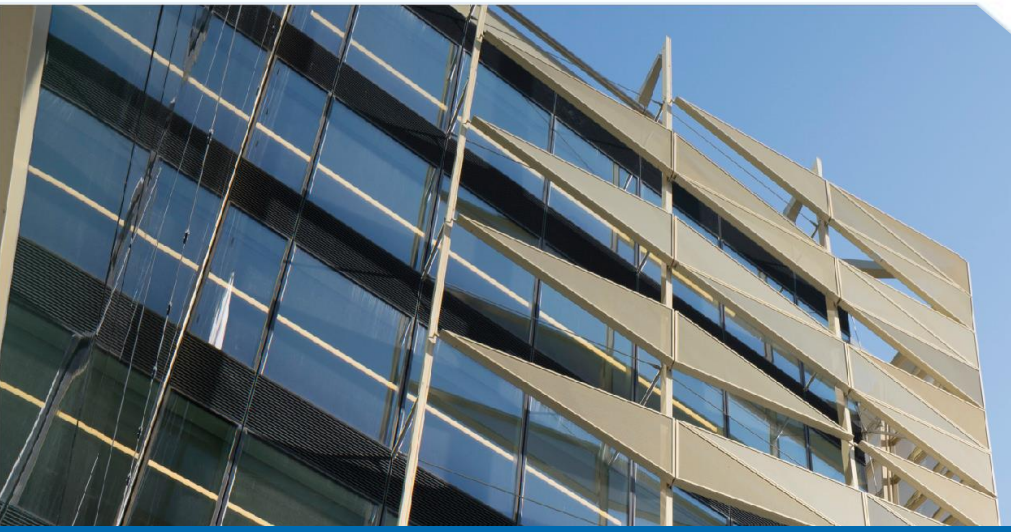

Financial fragilities and risk-taking in the aftermath of market stress

Branzoli, Gallo, Ilari & Poritoli (2022)

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Summary

1. Examines the effects of COVID-19 related asset purchase programmes on risk-taking behaviour of corporate bond funds.
2. Mechanism: asset purchases lower uncertainty, reducing risk of pre-emptive runs, thereby prompting greater risk-taking by funds ex-ante more exposed to asset purchases.
3. Reduces incentive to de-risk given poor performance (undoes the “reverse tournament”).
4. Security level data from Morning Star for 12 month period (Dec 2019 – Dec 2020) for EU and US corporate bond funds.
5. Implicitly uses a diff-in-diff style strategy whereby exposure is treatment and post period is post initiation of purchases.

Overview

1. Really interesting paper, less explored area in the literature. Important to understand resilience of investment funds to shocks as non-bank financing grows in importance.

2. Comments

3. Minor comments

Comment #1

2.3. Measuring active-risk taking

Following Cutura et al. (2020), the change between the average riskiness of the portfolio of fund *f* between month *t-1* and *t* is computed using Eq. (1).

$$\Delta Risk_{f,t} = \sum_{j=1}^{N_{f,t}} \lambda_{f,j,t} \text{ x } Riskiness_{j,t-1} - \sum_{j=1}^{N_{f,t-1}} \omega_{f,j,t-1} \text{ x } Riskiness_{j,t-1} \qquad (1)$$

$Riskiness_{j,t-1}$ is either bond rating or Roll illiquidity measure (respectively for credit and liquidity risk) of asset *j* in month *t-1*. The security-level weights $\lambda_{f,j,t}$ and $\omega_{f,j,t-1}$ used for the aggregation are given by:

$$\lambda_{f,j,t} = \frac{P_{j,t-1}Q_{f,j,t}}{\sum_j P_{j,t-1}Q_{f,j,t}} \qquad \omega_{f,j,t-1} = \frac{P_{j,t-1}Q_{f,j,t-1}}{\sum_j P_{j,t-1}Q_{f,j,t-1}}$$

Active rebalancing and the dependent variable

The metric used holds price and riskiness constant (at previous period value) while quantities vary i.e. a pairwise change across two periods.

Would be useful to see whether results change if price and risk were held constant with respect to February.

Comment #2

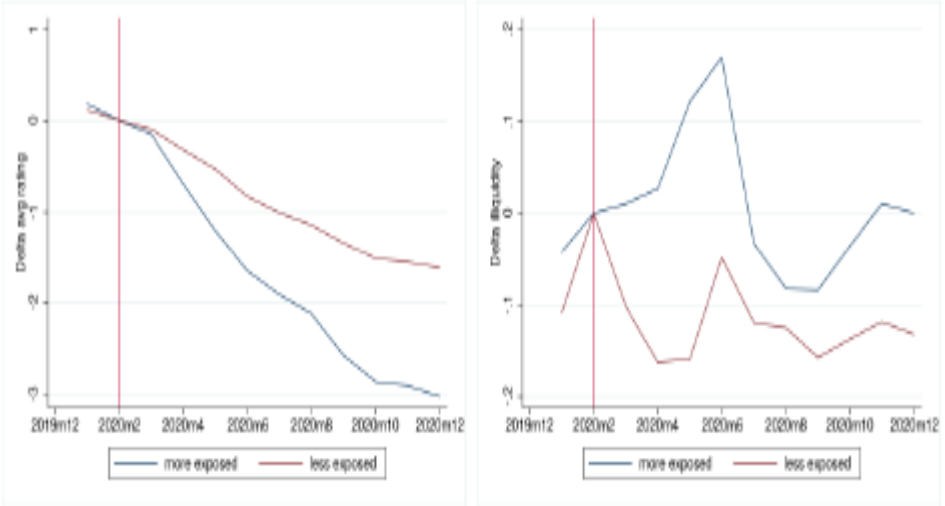
Quite a short pre-treatment period

The balancing tests provided indicate that the high and low exposure groups differ on certain characteristics. Difficult to assess whether it is the "treatment" which is having the effect or some other mechanism.

Could the period considered in the analysis be extended to provide more of an indication of whether the two groups move in parallel prior to treatment.

Figure 4 – Change in risk-taking measures across more and less exposed funds (index: February 2020=0).

a) Cumulative change in the average credit rating *b) Cumulative change in the average illiquidity measure*



Note. More exposed funds are those with a share of assets eligible for AP-C19 above the median at February 2020; while less exposed ones are funds with a share below the median. The change in the average credit rating of funds' portfolio is expressed in rating points by using a 22-level scale, while the change in the illiquidity measure, based on Roll (1984), is expressed in points.

Comment # 3

Implicit assumption that the share of actual purchases in eligible for purchase is constant across funds.

Assuming that purchases rather than eligibility matters, it seems important for identification of the effect to understand whether the share of actual purchases in eligible for purchase is constant across funds.

Could this assumption be examined by getting euro area purchase data from ECB?

Additional advantage of allowing you to conduct a similar test to Falato et al. (2021) except you could have purchased and quasi-purchased securities.

Minor comments

1. On the extensions for laggard funds and fragile funds, it would be helpful to see some sort of matrix of high and low exposure versus laggard/non-laggard to get a sense of the amount of variation.
2. It would be useful to have some balancing tests on the comparison of funds with top 4-5 year exposure and 5-6 year exposures.
3. Could Falato et al. (2021) type test be extended to BOE/ECB <1year, >1year securities?
4. Net inflows as a control variable? If we think of exposure affecting inflows which in turn affects risk taking, there is a possibility of bias.