

## **Discussion of**

**“How important is the distribution channel  
for mutual fund flows?”**

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# Empirical Setting and Strategy

- **Denmark** → retail mutual funds (MF) distributed through banks
- **Denmark** → detailed demographics (education, income, age, etc.) and complete (non-retirement) MF holdings of each adult
- **Experiment:** Small bank failures (mostly 2008, but also 2009 and 2011) result in “forced switch” of small bank depositors to five large banks
- **Strategy:** Compare **% affiliated MF holdings** and average **Morningstar ratings** of “forced switchers” to non-switchers at five acquiring banks (and largest bank, which is not involved in these mergers)
- Sample of six banks covers **68%** of depositors and **83%** of MF investors
- Affiliation inferred from names (e.g., Nordea Bank and Nordea Invest)
- *Not possible for authors to identify MF affiliations with failed banks*

# Treatment and Control

- **Treatment:** main account at failing bank branch in year  $t$  and newly created post-merger bank branch in year  $t+1$
- *How often do depositors move from failing bank branch in year  $t$  to different bank branch in year  $t+1$ ? To extent that not all depositors become forced switchers, what demographics predict selection into treatment?*
- **Control:** Because acquirers are largest banks, non-switchers are existing customers of largest banks
- *While Treatment and Control groups have similar demographics, there is no discussion of whether selection into smaller banks was driven by geography (harmless) or access to different menus of investment products*
- **Treated:**
  - ~**120,000** forced switchers to banks 2-5
  - ~ **12,000** MF holders (**10.0%** of depositors)
- **Full sample:** ~ 2.9 million across banks 1-6 (and ~640,000 switchers)
  - ~365,000 MF holders (12.5% of depositors)

# Baseline Findings

- Pr(large bank depositor holds any affiliated MF) = **78.5%**
- Marginal effects range across banks from **46%** to **79%**
  - *Quality of affiliated MF may vary across banks*
  - *Size and scope of affiliated MF menu may vary across banks*
  - *Incentives to recommend affiliated MF may vary across banks*
  - *Authors do not say anything about possible sources of across-bank variation... or test whether causal effect of distribution varies across banks*
- R2 jump dramatically with bank relationship variables

# Findings Based on Force Switchers

1. Distribution has causal effect on MF holdings
2. Causal effect is economically significant (1/3<sup>rd</sup>)

	Fraction holding any affiliated MFs					Change % Affiliated	Change \$ Affiliated
	t	t+1	t+2	t+3	t+4		
<b>Forced Switchers</b>	2.6%	13.4%	35.6%	42.5%	50.5%	47.9%	<b>35.3%</b>
<b>All Joiners</b>	33.1%	42.4%	50.1%	58.2%	69.4%	36.3%	<b>31.9%</b>
<b>All Leavers</b>	53.1%	46.0%	42.4%	36.1%	30.8%	-22.3%	<b>-22.5%</b>
	2008	2009	2010	2011	2012		
<b>Non-switchers</b>	82.8%	82.2%	82.7%	83.0%	83.1%	0.3%	<b>-0.4%</b>

3. Causal effect is “detrimental” (as measured by lower average Morningstar ratings)

# Putting Findings 1 & 2 in Context

- **Evidence that “Distribution has causal effect on MF holdings”?**
  - Foerster, Linnainmaa, Melzer, Previtro (JF 2017) use similar empirical strategy to show broker clients hold related portfolios
  - Sokolinski (WP 2019) shows that commission reduction in Israel leads to increased demand for lower-commission funds
  - Chalmers & Reuter (JFE Forthcoming) document effect of retirement plan change on portfolios of advice seekers
- **Evidence that “Causal effect is economically significant”?**
  - Bergstresser, Chalmers, Tufano (RFS 2009) and Del Guercio & Reuter (JF 2014) show that advice seekers end up in US market segment less focused on generating alpha
- **Aside:** I interpret Linnainmaa, Melzer, Previtro (JF Forthcoming) as showing that conflicts of interest arise through hiring decisions

# Differential Treatment?

- The **35.3%** increase in allocation to (newly) affiliated MFs is striking
- Corresponding multivariate estimate is **28.9%** (t-stat of 54.4!)
- *Do treatment effects vary across the five banks (which may offer stronger or weaker sales incentives to their advisers)?*
- Do treatment effects vary with demographics?
  - The authors state that they tested for interactive effects using wealth and did not find any evidence
  - *How about interactions with education level? Income level? An index that combines data on education and income?*
- Aside: Two-way clustering SEs on bank and year is infeasible given the small number of clusters. How about bootstrapping SEs?

# Variation in Fund Quality?

- Authors: “There is generally no reason to expect any relation between the performance of a bank and the performance of its affiliated funds”
- However, they also state that affiliated MF may receive numerous services from and pay various fees to affiliated banks
- If fee levels or level of investor stickiness vary across affiliated MF and banks, then quality may vary as well
- *Is distribution of Morningstar ratings similar across the six banks?*
- *Is distribution similar when comparing MFs affiliated with big banks to all other MFs?*



# Are Forced Switches Detrimental?

- [Chalmers & Reuter \(JFE Forthcoming\)](#) emphasize need to measure value of investment advice relative to counterfactual holdings
- Authors do not compare risk-adjusted performance of portfolios in year  $t+1$ ,  $t+2$ , etc. to those held immediately prior to merger
- Conclusion that forced switches are detrimental is based on decline in average Morningstar rating of forced switchers
  - **Figure 4:** VW average declines from **3.2** to **2.9** (*Would be nice to see decline driven by trading rather than mean reversion*)
  - **Figure 6:** Post-switch trades underweight 5-star funds and overweight 2-star and 3-star funds relative to Pre-switch
  - **Figure 7:** Average rating of purchased funds converges to average rating within full sample of funds

# Detrimental (2)

- Are the authors focused on 3-year ratings? Overall rating?
  - *I recommend comparing 3-year ratings in year  $t$  and year  $t+3$*
- How should I think about investment menus?
  - Do all banks offer access to all MFs?
  - Easier for depositor in Nordea Bank to buy Nordea Invest MF?
  - *Either way, curious to see a version of Table 6 that includes bank-by-year fixed effects, so that comparison is within bank*
  - *Also curious to see if impact of force switchers on ratings varies significantly across banks*
  - *Finally, can authors show trading by forced switchers has differentially negative effect on portfolio ratings?*

# Summary

- Authors use very cool data and exogenous variation to shed light on a MF distribution model that is quite popular outside of the US
- Forced switchers increase holdings of affiliated MFs at the expense of lower average Morningstar ratings
- Interpretation? Forced switchers succumb to conflicted advice
- Lingering question: How do we reconcile 69% of assets in affiliated MFs and strong population-level demand for 5-star funds with tilt towards lower-rated funds by forced switchers?
  - Does persuasiveness of bank advice fade over time?
  - Does definition of force switchers skew sample towards less sophisticated MF investors?