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(Country) Home bias in Italian occupational pension funds asset allocation choices

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ABSTRACT

This paper expands the current literature on home bias and in country home bias especially, in five ways: (a) it analyzes an unexamined market, that of Italian occupational pension funds; (b) it considers three asset classes: government securities, corporate bonds and equities; (c) it examines the choices made by professional managers; (d) it checks whether the presence of Italian home bias is influenced by the benchmark or not and (e) it examines whether Italian home bias influences Italian asset managers and if it is also identifiable in the case of *coacting* management in the presence of one or more Italian asset managers. The results obtained demonstrate that home bias is a phenomenon that can be argued to exist in Italian occupational pension fund asset manager's asset allocation. The results of this research tend to show that when the asset manager is Italian, single or *coacting*, the choice falls on Italian asset classes. Finally, the home bias phenomenon could be considered an element for containing volatility in the prices of government securities, corporate bonds and equities because of the constant demand created on the market by the asset managers affected by this bias.

1. Introduction

The pension fund reform implemented by the Italian Government in 2007 has contributed to the growth in size of Italian occupational pension funds. In fact, the most important part of this reform is the mechanism of employees' automatic enrolment on occupational pension fund in the aim of increase participation in supplementary pension systems. In this way, the pension fund collect the employee's contribution, that of the employer, and the accumulated severance pay. According to the Pension Funds Supervision Commission (COVIP) at the end of 2011 the total assets under management amounted to over 22 billion euros, with an increase of 173% compared to 2007. Therefore this area has become an important business sector for asset managers.

Each Italian occupational pension fund presents its investors with a choice of various unit-linked funds with different levels of risk. The money is managed by professional managers, Italian and/or foreign. With reference to the pension funds system, when occupational pension funds are managed by more than one manager each manager receives a mandate to manage a part of the assets collected but they are independent of each other in the choices they make. This behaviour is called *coacting*. The distinction between *coacting* and *noncoacting* was indicated by Zanjonc (1965). He defines the *coacting* effects as when "we observe individuals all simultaneously engaged in the same activity and in full view of each other" (p. 270). Based on the stipulated agreement, managers (individually or *coacting*) establish asset allocation for each unit-linked fund, considering government securities, corporate bonds and/or equities[1]. Considering government securities, managers can choose to invest in Italian government securities and/or those issued by Organization for Economic Co-operation and Development (OECD) countries and/or non-OECD countries. Of corporate bonds, those issued by Italian firms and/or those issued by OECD-country companies and/or those of non-OECD-country companies can be chosen. The same selection can be made by managers with reference to equities.

The aim of this paper is to investigate the presence of Italian home bias in asset allocation choices made by professional managers in the field of Italian occupational pension funds. In the literature home bias is defined as the preference for the allocation of savings and consumption to domestic products (Coval &

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[1] It is also possible invest in mutual funds, Italian or foreign, but this is a very rarely-chosen option; for this reason this asset class is not taken into consideration in the paper.

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Moskowitz, 1999; Evans, 2001; Hillberry & Hummels, 2002; Amadi, 2004; Giofrè, 2008). Fisher and Statman (1997), Chan, Covrig, and Ng (2005) and Hau and Rey (2008) examine the existance of home bias in mutual fund asset allocation. This paper expands the current literature on home bias, and in country home bias especially, in five ways, by (a) analyzing an unexamined market, that of Italian occupational pension funds; (b) considering three asset classes, government securities, corporate bonds and equities; (c) examining the choices made by professional managers; (d) checking whether the presence of Italian home bias is influenced by the benchmark or not and (e) examining whether Italian home bias occurs in the case of Italian asset managers and if it is also identifiable in the case of *coacting* management with one or more Italian asset managers.

The paper is organized as follows: Section 2 presents a brief review of the main literature on home bias; Section 3 presents data and methodology; Section 4 shows the main results and Section 5 concludes.

2. Literature review

In the literature home bias is defined as a preference for the allocation of savings and consumption to domestic products (Coval & Moskowitz, 1999; Evans, 2001; Hillberry & Hummels, 2002; Amadi, 2004; Giofrè, 2008). An ever-growing body of studies have investigated the determinants of home bias from both a rational and a behavioral perspective. These studies examine transaction costs (Glassman & Riddick, 2001), real exchange rate risk (Fidora, Fratzcher, & Thimann, 2006), information barriers (Ahearne, Griever, & Warnok, 2004), corporate governance issues (Dahlquist, Pinkowitz, Stulz, & Williamson, 2003) and lack of familiarity (Portes & Rey, 2005) to name a few. However, home bias is considered one of the main causes of international market fragmentation, as people tend to not fully consider the opportunities offered by international diversification (Gehrig, 1993; Tesar & Werner, 1995; Lewis, 1999; Huberman, 2001).

According to French and Poterba (1991) investors do not diversify internationally; in fact, they estimate that U.S., Japanese and UK. investors hold 93%, 98% and 82% respectively of their equity investments in their home countries. Coval and Moskowitz (1999) demonstrate that U.S. investment managers exibit a strong preference for locally headquartered firms, particularly small, highly levered firms that produce nontraded goods, in their domestic portfolios. According to Huberman (2001), people prefer to invest in the familiar and they feel comfortable investing their money in a business that is visible to them. The author demonstrates that many individuals tend to invest in the stock of the firm in which they work. In that way they double their risk concentration: on the one hand, they invest in few stocks without appropriate diversification, and on the other financial risk tends to correspond to job loss risk.

Cooper and Kaplanis (1994) test for home bias by considering the levels of risk aversion among investors, while Barber and Odean (2001) demonstrate that men are more prone to home bias than women, and older investors choose domestic stocks more frequentely than younger ones. These conclusions are confirmed by Karlossn and Norden (2007). These authors show that investors affected by home bias are not overly sophisticated, have a stable job, are getting on in years and tend to opt for safety.

The existence of country home bias is demonstrated by many authors for different countries: Dahlquist and Robertsson (2001) investigate the Swedish market; Grinblatt and Keloharju (2001) analyze the Finnish market; Ahearne et al. (2004) examine the U.S.; the Japanese market is investigated by Kang and Stulz (1997). Magi (2009) numerically solve a theoretical dynamic model of international portfolio choices in order to investigate and explain the italian equity home bias. The author does not consider professional manager asset allocation choices and does not consider occupational pension funds. He argues that people with poor capabilities of processing informazion do not diversify their financial investments.

Mutual fund asset allocation has also been investigated. Chan et al. (2005) examine how mutual funds from 26 developed and developing countries allocate their investments between domestic and foreign equity markets. They find that these funds overall allocate a disproportionately larger fraction of investment to domestic stocks. In the same field, Hau and Rey (2008) find a positive correlation between fund size and home bias, as well as a positive correlation between fund size, the number of foreign countries and the number of sectors in which they invest. Finally, Fisher and Statman (1997) show that mutual fund management advice is also prone to home bias.

This paper aims to test for the presence of home bias in Italian occupational pension fund asset allocation choices made by professional managers. The approach used is totally different compared to Magi's analysis (2009) which was purely theoretical whereas this paper considers asset allocation choices actually made by professional managers during 2007–2011; it considers Italian occupational pension funds, a field unexamined in literature and, in particular, it considers three asset classes: government securities, corporate governance and equities.

3. Data and methodology

3.1. The sample

The database used in this paper was created from the 35 Italian occupational pension funds existing at the end of 2007 (the year of the introduction of Italian pension reform) identified and recognized by the Pension Funds Supervision Commission (Covip). Those no longer operating at the end of 2011 (5) were eliminated. The occupational pension funds existing before 2007, and which did not provide a guaranteed unit-linked fund, had to introduce one; for this reason 2007 represents a year of strong discontinuity with the past.

For each unit-linked fund of each occupational pension fund we have analyzed the balance sheet from the years 2007–2011 in order to gather information about (a) total assets under management (AUM); (b) the asset under management (AUM) invested in Italian government securities, in corporate bonds of Italian firms and in Italian equities; (c) the managers and their nationality; (d) whether the managers operated individually or *coacting* and (e) the benchmark established by the agreement.

3.2. Methodology and variables

To test for the presence of home bias in Italian occupational pension fund asset allocation a regression was used as follows:

$$\text{Asset}_i = \alpha \text{w\_bench} + \beta \text{riskunit} + \sum_{j=1}^{\text{other}} \sum_{\substack{i=1\\z=1}}^{\substack{6\\n}} \delta_i\_K_{zj} + \sum_{i=1}^{5} t_i + \sum_{\substack{i=1\\t=1}}^{\substack{5\\n}} \varepsilon_{it} \tag{1}$$

where Asset_t is the percentage of the capital invested in Italian government securities (ITGS), Italian corporate bonds (ITCB) and Italian equities (ITE) out of the total amount investible respectively, calculated at the end of each year (2007–2011) per each unit-linked fund. Each regression was assessed using ITGS, ITCB and ITE alternately. w_bench is the percentage of Italian investments indicated by the benchmark per each unit-linked fund; riskunit type from