Discussion of:
Fund Size and Managers’ Risk-Shifting
by Ping Mclemore, George Jiang, and Ao Wang

Discussed by Pingle Wang
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November 2019
Fund managers change their risk levels for many reasons:

- **Tournament:**
  - Brown et al. (1996), Kempf and Ruenzi (2008)

- **Flow-performance sensitivity:**

- **Employment risk:**
  - Kempf et al. (2008)
Mutual Fund Risk-shifting

Fund managers change their risk levels for many reasons:

- **Tournament:**
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- **Flow-performance sensitivity:**
  - Chevalier and Ellison (1997), Huang et al. (2007)

- **Employment risk:**
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How do we measure risk-shifting?

- **Return based:**
  - volatility of returns
  - tracking error to benchmark portfolio
  - systematic risk and idiosyncratic risk

- **Holding based (Huang et al. (2011):**
  \[ \sigma_{Holding, t} - \sigma_{Realized, t} \]
This Paper

- **Goal:** Does size affect a fund’s risk-taking behavior?
- **Challenge:** Size is not randomly assigned.
- **Solution:** Using fund merger as a shock to fund size
- **Findings:**
  - Main result - fund volatility decreases after mergers
  - Liquidity matters - Small-cap funds experience larger downward risk-shifting than large-cap.
  - Fee matters - High 12b-1 funds experience larger downward risk-shifting than low fee funds.

**My discussion**

- Alternative explanations
- Empirical methods
- Suggestions
Main result

- Blue bar: \( \text{std}(\text{ret}_{-36,-1}^{\text{Acquiring}}) \)
- Red bar: \( \text{std}(\text{ret}_{13,36}^{\text{Merged}}) \)
Alternative explanation: diversification

- Acquiring Fund + Target Fund $\rightarrow$ Merged Fund
- It is not exactly an apple-to-apple comparison.
- Suppose $\sigma^{\text{Target}} = \sigma^{\text{Acquiring}}$, and $\rho(\text{ret}^{\text{Target}}, \text{ret}^{\text{Acquiring}}) < 1$:
  \[
  \sigma^{\text{Merged}} < \sigma^{\text{Acquiring}}
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- ..., which also explains heterogeneous effect between small-cap and large-cap funds
  - Less comovement among small stocks than large stocks
  - Benefit of diversification is greater for small-cap
Alternative explanation: Time-varying Volatility

- Substantial movement of aggregated idiosyncratic volatility
  - Coincide with years when most of fund merger happens
  - All funds are shifting risk downward, not just merged funds with size shocks.

Bottom line: return-based risk measures are subject to time-varying market conditions.

Holding-based risk-shifting measures discussed by Pingle Wang.
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Bottom line: return-based risk measures are subject to time-varying market conditions.

- Holding-based risk-shifting measures
Mechanism

Where does the reduced risk come from?
- Systematic risk or idiosyncratic risk
- Tracking errors
- Change in fund managers due to merger
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Minor Comment:

- Tables 4 to 12: Panel regression, but dependent variable is populated pre- and post-merger.
  - Essentially, these are just two data points.