Discussion:
The Market for OTC Derivatives

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The story

- Banks heterogeneously exposed to an aggregate risk factor.
- Each bank has several trading desks, that randomly meet desks of other banks and trade CDSs.
- Different desks of the same bank buy or sell insurance depending on whether their counterpart is less or more exposed to the risk factor $\Rightarrow$ price dispersion, gross volume $\neq$ net volume.
- Banks with balanced exposure naturally emerge as dealers.
- Positive analysis: the model matches stylized facts - links between gross volume, net volume, bank size.
- Normative analysis: too many intermediaries enter (business stealing), too few "customers" enter (positive externality).
- Elegant model based on general assumptions and first principles.

What is a dealer?

- A bank that happens to have $\omega \simeq 1/2$.
- Imagine the game is repeated:
  - If we draw a new ω in each period, is this bank really a dealer?
  - Otherwise if ω stays the same, why random matching?
- Important feature of a dealer is that he can easily be contacted, different contact probability as in Duffie, Garleanu, Pedersen 2005.
- Dealers or "opportunistic" intermediaries?
- However: the authors' assumption that dealers are like other banks plays against their results, and avoids assuming ex ante that dealers are special.
- More generally: entry cost should be paid once for many periods with different realizations of ω. Reduced form for a model where banks have different distributions for their ω?

What is a bank?

- A coalition of traders $\Rightarrow$ modeling innovation.
- All traders of a bank have the same risk exposure ω. Paper sometimes a bit confusing (ω-trader / ω-bank).
- Underlying assumption: the bank's traders can trade with each other and thus equalize their positions before entering the OTC market.
- Is it clear that they should all have the same limit k? Presumably, desks with a high k are those that can enter in large exposures ω AND write many CDS contracts. The trading limit could even take into account that risk is hedged.
- Not key, but clarifying the status of the assumption would be helpful: nice modeling device, or realism? If the latter, more discussion would be interesting.

Welfare

- Too many dealers, not enough customers enter.
- Implies that the ratio gross volume/net volume is indeed excessive?
- Links with earlier works in the labor literature?
- Policy tools to solve this problem? An FTT for instance?
- Multiple equilibria seem quite natural: entry by the $\omega \simeq 0$ and entry by the $\omega \simeq 1$ are complements, entry by types $\omega \simeq 1/2$ are substitutes. Maybe additional implications?

Going further

- Nice model deriving a rich OTC market for derivatives from first principles.
- Could future papers extend the analysis to speak more to current policy debates? Counterparty risk, price opacity for instance.
- Dodd-Frank and Volcker only mentioned at the end (what about EMIR?), policy implications of the paper deserve more discussion (for instance impact of c and k).

Other comments - 1

- ▶ Section 5.3.3. should be emphasized much more, with parts of propositions 14 and 15 in the main text. More discussion of the testable implications (merge with 6.3?).

- ▶ $k < \infty$ mentioned as a fundamental friction p. 1, would be interesting to spend more time on the case without this friction to understand the impact.

- ▶ Why not assume from the beginning that D is normally distributed? Pb. that $D \in [0, 1]$, but one can assume the payoff is $\omega \times X$, where $X \hookrightarrow \mathcal{N}$ instead of focusing on loans and CDS?

- ▶ Further simplification: assume from the beginning that $n(\omega)$ is U-shaped and symmetric, as is obtained in equilibrium (the Appendix still needs to consider the general case to solve for entry).

- ▶ Could be interesting to discuss more what the assumption of coalitions of traders buys in terms of modeling, methodological contribution.

Other comments - 2

- More assumptions could be introduced at the beginning instead of being unraveled along the road.
- Early introduction of the case $\omega \in \{0, 1/2, 1\}$ could provide a nice illustration.
- Consider having a single section comprising the stylized facts and the empirical implications.
- "Excess volume" compared to Walrasian benchmark, but negative connotation.
- Graphical illustration of the matching technology?

Conclusion

- Important and timely paper.
- Deep economics.
- Nice model of OTC derivatives markets, replicates many stylized facts.
- Interesting normative conclusions, could be more developed and linked to policy debates.
- Can the model serve as a workhorse in the future? How to introduce counterparty risk for instance?

Thank you!