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**Comment**      Antoinette Schoar

I really enjoyed reading this chapter and as you probably already got a sense from Peter's and Josh's discussion, this is a very different empirical approach than what we normally see, especially in applied microempirical work. So what I want to do in this Comment is first outline where I think the strength of this approach comes from and then show you how it compares to more standard microempirical work that we normally do in policy evaluations, and how these two can complement each other. So I think it would be helpful to understand whether innovation in financial markets in general could be different from other product markets and why.

To me, it seems that there is this basic tension that has become very prominent in our minds about innovation in financial markets, in particular over the last three years. Of course, there are many financial innovations to share risks between households or lower the transaction costs of accessing markets—I guess we would all agree that these are useful product innovations in finance that help firms and households improve their financial decisions, such as investment and savings, and so forth. But there is this other big worry with financial innovation—they seem often to have big distributional implications or, in Peter's language, externalities. In particular, I think the two big things that worry me about the role of financial innovations is, first it looks like there is a lot of financial innovation that seems to be aimed at generating fees for the financial institutions, but that do not necessarily have much impact on helping people improve financial functions. And then the second aspect is that because of confusion of retail investors or large looming agency problems, there seems to be a lot of innovation that leads to mis-selling. Either because, as Peter says in the chapter, later adopters of these innovations do not understand them so well, or maybe because from the beginning they might be targeted to exploit the confusion of retail investors in those markets.

So why do we worry about this less in product markets and why should we be worrying about it in finance? In my mind, the answer is to a large extent that it is very difficult to learn quickly about the quality of financial investments—it takes time. It is a very noisy updating process. If you buy a computer, you do not need to know what is going on inside it. But if it does not work the way you want, you will learn this pretty quickly and from then on you will buy a competitor's product. And that will cause quick feedback loops. Here competition actually does the trick and in many situations drives out the bad product. However, in financial markets that is not so clear. For

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your retirement savings, you actually will only know in thirty years whether your broker gave you good advice or whether the broker misled you. That is obviously too late.

And I think the big debate now in finance is, especially with the new consumer financial protection agency, how to strike the right balance between allowing innovations that improve the functioning of financial markets, but at the same time curb those innovations that are mainly aimed at extracting more rents from customers. This is where a lot of the tension comes from. And so that is what I really liked about the approach that Josh and Peter propose here: thinking about counterfactual histories in financial markets is something that, if you take this as an approach, actually forces us to think about long-term implications. And to me, it seems that this could be a tool to help us set an agenda for research. That is to say, what are the comparative statics that we really want to test and what are the trends that we should do much more empirical work on? So to me, the benefits of this approach are that they can play an agenda-setting role and help us systematically map the impact of innovation, in particular on other parts of the economy such as the political, social, and regulatory context.

The second thing I wanted to mention is that one could go even further and think within this context about how current innovation affects the occurrence of future innovation, either because it affects how regulation or market entry are affected. For example, if we have innovations that need to rely on big banks, it would have completely different implications for political capture going forward than innovations that lead to a more diffused financial system.

In contrast, there are two things that I found difficult to think about in their framework. One is that in fact you are setting the bar really high because you do not only want to see causality here. You want to see causality relative to a world that never happens. It is really difficult to do, partly because we might not know what other innovations that the world could have brought about had this one thing not happened. And so you have to make a lot of judgment calls.

Now the second thing I was struggling with here is that these counterfactual histories allow you to think about systemic impact on the grand scale, but for the more practical work of regulators and financial institutions, they have to make decisions based on real data. Most regulations are actually incremental rather than designing a full counterfactual history. And so this approach is not well-suited to allow us to understand the margins that regulatory intervention can affect. In the end, I also feel that this approach does not allow us to map out the channels through which innovation actually impacts the economy. Here a more traditional, complementary approach of microempirical studies can be more useful.

So the traditional microempirical approaches allow us to understand the local impact of marginal interventions. Instead of saying should we ever have

allowed CDOs to happen, or should we ever allow mutual funds to exist, the question that will help regulators is more incremental and might take the form of “should we set defaults for 401(k) plans and how should we set them”? Should we allow life cycle plans and how should they be structured? And I think these things can be answered with traditional microempirical approaches, but of course, it is the flipside of the counterfactual history.

So let me make a final suggestion; while I think that in general it is very important to understand innovation in financial markets, one dimension that is most interesting to me is to map out how innovations are either distorted or exacerbated through agency relationships and confusion of retail customers. So if we think about the consumer financial protection agency that is about to be set up, for example, we need to ask how market competition interacts with financial innovation and what is the impact of those innovations. Because the big problem that we are facing in household finance is that if indeed customers can be easily confused about the underlying quality of the financial products and services they buy it is not clear whether greater competition in these markets leads to a first best outcome. And therefore we have to think hard how regulation should work in this market.

In any case, I found it a very stimulating chapter. I think this type of approach needs to be juxtaposed with careful microempirical analysis.