TRANSFORMING FINANCIAL OTC MARKETS.
Struggles around categories

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MOTIVATION AND OBJECTIVES

- The question of categorization in the construction and the shaping of markets
- Lots of analyses provide insights for our understanding of categorization from a sociological viewpoint (e.g. Kennedy, 2008; Khaire & Wadhwani, 2010; Lounsbury & Rao, 2004; Zhao, 2005 …)
- Yet, few studies have precisely examined the process by which attempts at categorizing are contested.

*In this paper, we examine the way different market participants resist to solutions that will potentially significantly alter the definition of the market.*
RESEARCH QUESTIONS

1. What are the means by which powerful actors resist categories and contest a certain definition of the market?

1. How do struggles around categories envision a certain meaning of the market (Miller & O’Leary, 2007)?
ARGUMENT

- We argue that resistance to categorization is based on the creation of *incommensurables* (Espeland and Stevens, 1998)

- Additionally, we show that resistance to the new categorization relies mainly on defining the market in a very specific way.
THEORETICAL BACKGROUND (1)

- Categorization as an instance of commensuration and market construction

  Commensuration is defined as a process through which, different objects, attributes or people are compared, according to a common metric (Espeland & Stevens, 1998: 316--17).

  Stable shared meanings are essential to the process by which the terms of comparison and commensuration are established (Khaire & Wadhwani, 2010: 1283).
Categorization as a contested political process

Commensuration and categorization have to do with power and they can entail political processes (Espeland & Stevens, 1998; Lounsbury & Rao, 2004).

Creation of *incommensurables* (Espeland & Stevens, 1998) to resist categorization.

While Espeland & Stevens (1998: 323) note that “we are more likely to notice failure of commensuration than its widespread varied success”, we think that we need to explain more precisely how people contest categorization.
METHODOLOGY

- Research setting: OTC markets in the light of recent regulatory change.

- Qualitative study from 2008 to 2011

- Sources of data:
  - Archival materials,
  - MIFID-consultation,
  - Press articles

- Data analysis
CASE STUDY

- **Resisting categorization**
  - Regulation to come:
    - Dodd Franck Act in the US
    - MiFID 2 in the EU
  - Both still under consultation

- **Basis: the September 2009 G20 summit**
  - “all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest.”
CASE STUDY

- Creating Incommensurables
  - Struggles over the definition of products
    - The eligibility issue
      - Standardization is not a relevant criterion
      - Liquidity is not a relevant criterion
        - "a liquidity criterion would be difficult to administer in practice"
        - the liquidity threshold would have to be “set at a realistic level that differentiates between products, capable of being calculated and predicted, subject to periodic review and able to accommodate temporary changes in the market”.
      - Complexity is not a relevant criterion
        - «a false link is sometimes made between product complexity and product risk, which leads to the illusion that complex instruments are automatically high-risk instruments".
CASE STUDY

Creating Incommensurables

Struggles over electronic venues’ regimes

The MTF Regime

The SEF and OTF Regimes

- **Which pretrade transparency requirements?**
  - The AMF suggests a distinction between a sort of “supra-OTF regime” for which: “requirements (governance/organization, multilaterality, pre-trade transparency etc..) should be very demanding, and “regular” OTFs, primarily aimed at trading in less liquid financial instruments”.

- **Contesting the transparency principle itself**
  - "In general terms transparency in markets can help to build confidence, by ensuring that participants have access to information. However, there are products and markets, which are so illiquid, that revealing trade information could actually be detrimental to buyers and sellers. We have to balance the benefits of transparency versus the potential downsides". (Citi- Mifid consultation)
CASE STUDY

Creating Incommensurables

Struggles over electronic venues’ regimes

- Struggling over definitions
  - A price on OTC market is something special:
    “A price will always reflect the situation at the time it is made and therefore will not necessarily be comparable”.

CASE STUDY

- **Maintaining social boundaries and status**
  - **Maintaining the clubby nature of the market**
    - “Finally, one should keep in mind that the more transparent the markets, the more difficult it would be to limit their access to all sorts of investors. It may not be wise to let retail investors feel as if it would be good for them to invest in derivatives instruments because they are traded on an exchange (or trading platform)” (ABBL Bankers Luxembourg- Mifid consultation).
  
- **Controlling the access to central clearing platforms**
Discussing the nature of the market

“We are concerned that the approach proposed does not fully take into account the nature of the OTC derivatives market. We feel it is essential to understand that execution mechanisms for OTC products must be appropriate” (Deutsche Bank-Mifid consultation).

« Because of the bespoke nature of these transactions it is crucial that the dealer market retains the ability to trade with each other in a bespoke manner »

“Efforts to centralize and standardize OTC trading could: - Harm the EU market as a whole - investors cannot get the specific solutions they seek and this may, in turn, have an effect on the services they provide; - Lead to an actual increase in systemic risk on account of restrictions in OTC trading (and the ability of market participants to hedge); - Harm the reputation of the EU as a financial centre with innovative and sophisticated products being traded out of Asia instead”. (Crédit Suisse- Mifid Consultation)
Conclusion

- Incumbent firms struggle for categorization’s status quo (Lounsbury and Rao (2004))
- They do so by attempting to build incommensurability
  - A powerful tool: hyper-sophistication and technicity as reflected by the use of acronyms, the contestation of categories, the multiplication of definitions.
    => convey a vision where the present social order is too complex to be easily transformed.
  - A handicap? The part taken by theory – here financial theory – as a cultural repertoire for parties at stake in the debate.