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Reflections of Value in Trading Rooms

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How does a bank work? Is information theory sufficient to the understanding of the complex interactions between clients and the different professions involved in creating financial products? Using Bruno Latour's sociology of sciences, an innovative study takes its chances at solving some of the most difficult riddles of contemporary financial theory.

Reviewed: Vincent Antonin Lépinay, *Codes of Finance. Engineering derivatives in a global bank*, Princeton University Press, Princeton, 2011

Vincent Antonin Lépinay offers us a rare look at a global French bank at the beginning of the 2000s. Thanks to very original material, the author brings to us the everyday concerns of traders, salespeople, financial engineers and back office employees. Lepinay examines individual experiences but also the multiple organizational issues their interactions generate. Power struggles around bonuses are addressed, as are symbolic and monetary hierarchies among and within professions, and the complexities of dealing with different sources of information that need to be standardized for operational, accounting and other regulatory requirements. Situated within a discussion with the works of Michel Callon and Bruno Latour, the book explores the case of a derivative whose innovative character increases the puzzles for employees who cannot always follow existing standardized paths. The author explores how the reality that the actors operate within is partly created by their own models and theories. Despite a somewhat hermetic

vocabulary, this approach makes the book a very original work which should be of interest to students and researchers interested in business administration, the sociology of firms and the intricacies of daily interactions in trading rooms.

Designing a New Financial Product

The book centers on a specific financial product, a combination of insurance and investment into a single contract. At the end of the investment period, which may last several years, the buyer, i.e. the client of the bank, recovers a guaranteed 100% of the initial investment, and a percentage of the gains of a combination of stock indexes. The client is allowed to change some of the features of the product along the way. In the early 2000s, when the author conducted research, this kind of product was still considered innovative, and that was part of its marketing branding.

The author explains how the product is initially devised by constant exchanges with potential clients and by imagining an abstract "ideal" client. The work of the financial engineers is at the center of this pursuit, as they mobilize their knowledge in mathematics to find combinations of price movements and patterns of return among different available financial products, such as indexes and options, in order to create a new combination that is a profitable and sellable contract. Once the product is devised and sold, the work of the traders is then to make sure that the money brought by the client is invested in such a way that, at the end of the contract, the bank can pay what it promised and still come out with a profit. In order to do so, traders follow several guidelines inscribed in the design of the product by the engineers, and must venture into specific markets, for instance those concerning the stock indexes mentioned in the contract, on which they may not be specialized. This implies gathering information from several sources and taking positions on a constant basis, for a bundle of products, and during several years. They do so aided by a "pricer," a software that gives them a monetary value of their positions, a "price" that does not exist in an actual market, but is obtained by modeling. The back office employees must make sure that all these transactions are registered correctly according to the contracts signed by the bank. The accounting department, in turn, needs to come out with a pricing of the positions in order to inscribe them in the accounting documents that will

be presented to regulatory authorities and to the shareholders of the publicly listed bank.

The stage is set for conflicts between salespeople and traders. The bank's returns on the sale of the contracts come from a margin extracted from the cash brought in by the client. While salespeople's bonuses depend on how many contracts they sell, trader's bonuses depend on the performance of their portfolio, which is partly priced by the traders themselves. Salespeople attempt to know the valuation of the portfolio, in order to gauge how much they can lower the price exacted on the client, a type of information that traders are not keen to give out. This is part of the many struggles and misunderstandings concerning the definition of the product and of the liabilities and profits it implies for the bank, and involving the financial engineers, the traders, the back office and the accounting department, who all use different frames of analysis to achieve different professional aims. The product being relatively new and implying liabilities for the bank in the long run, it also means that its long-term profitability may be in doubt, while most of the employees engage in a constant struggle for bonuses and salaries, which depend on the sale of a maximum of products in the shortest term possible.

Academic books offering rich descriptions of the inner workings of the financial industry are still rare, but the literature is growing. Annelise Riles recently published an analysis of the epistemic conundrums faced by the juridical department of a Japanese bank trying to come to terms with the notion of "collateral" (2011). Karen Ho explored, in a historical perspective, a homology between the discourse on the mobility and instability of jobs within the financial industry in Wall Street and the way in which this industry influences the transformation of the rest of the US economy by rendering it more adaptable to financial decisions (2009). Lépinay's book combines a deep analysis of the epistemic issues raised by a specific financial derivative product with a study of how these controversies are part of the work relations within the bank. The case studied is extremely original, as is the qualitative, often very rich data.

Are Financial Transactions Mainly Attempts at Solving Epistemic Problems?

Lépinay relates his research to the sociology of science of Bruno Latour. Eschewing an ontological discussion of agency, which some researchers within this trend attempt to situate

both in humans and in “non-human actors” (such as “theories” and “objects themselves”), he retains the question of the “truth” of the “reality” that the actors operate with and that is partly the result of their own deeds. Carrying this problematization of scientific practice on to the trading room, the author states that it can be compared to a scientific laboratory. This assertion is somewhat surprising, and no attempt at justifying it is made in the book. Within this frame, the author considers that the main issue for the employees is the treatment of information and the definition of the product. He does analyze other social processes, such as the struggles for bonuses. But he does not relate the practices within the bank to the social and historical genealogy of investment banking, of trading desks and of the markets for derivatives products. To quote him, the financial product he studies “solves” “the needs of the client” through a relation of informational asymmetry. But we are left without any knowledge of the broader social processes in which these “clients”, their “needs” and their “solutions” come to exist the way they do, as though these processes were not important to understand the financial practices that the author studies.

This echoes today’s mainstream financial theory, which is mainly concerned with information as a tool for supply and demand to obtain market efficiency in equilibrium, in an abstract account where the interactions are a-historical and detached from any institutional and social setting. The author’s main interpretation of financial transactions as epistemic problems would have benefited from a more explicit discussion of its relation to this important body of academic work. This focus also accounts for the confusing organization of the book, which starts by discussing definitions of the product, and awaits the end of the book to make sense of it in relation to the clients and the commercial strategy of the company.

Is a Bank a Body?

The understanding of the trading room as a scientific laboratory is explicitly linked to an ontology of the firm, treated as a “body” whose interactions with the “outside” occur in terms of “porosity.” For the author, the bank is a self-sustained environment, and its owners and clients are “interferences” in it. Yet, as the author himself shows, the company sells products for profit in a commercial exchange and the clients are of course there from the beginning, a fact that goes

sometimes unappreciated because of the focus on the technical issues of the treatment of information. Such ontology of the firm also leads to an assertion that may be quite controversial. Some front office employees devised an in-house information system that could be used by both the front and back offices. Previously, each group had their own system, a situation that caused constant controversies and misunderstandings. The new system would allow treating the different professional definitions of the derivatives product within a single narrative. According to the author, the front office employees developed this system in order to prevent their desk from being sold to a rival bank, because of their emotional attachment to the firm. He does not, however, attempt to prove it, for example by using interviews, and even quotes some of the employees as brushing the issue off. This assertion counters the fact that entire desks often leave banks, not only because they are sold, but also because they prefer to work for the competition for higher salaries and bonuses. Olivier Godechot (2007) has consistently studied this process, showing how the capacity to leave with the software and the know-how explains the traders' bargaining power that secures their high bonuses. Given the assertions of the author, one would have expected a more direct confrontation with the material that seemed to counter his view.

The Difficulty of Addressing Value

The conclusion centers on the assertion that "derivation," which attains its "purest" form in finance, is "the source of value" in the economy, "production" being a sub-case of it. The author does not give a clear definition of "derivation" and "value." He rejects the labor-value ontologies of classical economics, and does not explicitly endorse the notion of "value creation" put forward in current financial theory, which quite prosaically means, in the context of a company, the fact that it makes money. Moreover, if this insufficiently defined "value" is the result of "derivation," the latter concept also requires clarification. It is at one point said to mean creating something "new" by profiting from the "wealth of untapped information and resources," for instance by combining insurance and investment into a single product. In this sense, the author's view seems close to Adam Smith's, according to whom market exchanges allow for new activities to appear and thereby for the creation of "wealth." Yet, if this was the framework, once the ontology of labor has been done away with, it remains unclear what has been "created," and why we should still call it "value." At another point, the author states that the definition of

value is “technical,” thus echoing a pragmatist approach that would proceed without ontological quest and would study not the creation of value, but the practices of valuation. In the conclusion, this last path seems to have been rejected. In this sense, the book shows the puzzle of mainstream financial talk today, which constantly states that “value” is “created” by linkages in the financial industry, but is unable to explain what this “value” is and how it can be assessed in social terms.

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