

Philosophical & Sociological Inquires in Material Aspects of the Human Life namely Risk, Finance and Insurance

Description

Given how much importance there is of economics and finance in our lives as humans (materialist side is foremost as per Marx), it should be given more importance by Philosophy and Sociology. This brief report is meant to highlight few research paradigms available in Philosophy and Sociology to give its proper social context and provide deep underlying of Risk, Insurance and Finance.

Sociology of Risk and Other Areas

Sociology of risk¹

A number of key insights on sociology of risk have been elucidated by the previous sections. Here, we emphasize that although sociology of risk attracts a lot of research activities, it is important to categorize it according to their core ideas. The three main categories are:

- risk in (rational) decision-making,
- risk in calculative-probabilistic calculation and
- risk as part of a modern worldview.

Different sides to the epistemological status of risk can be shown with following different approaches to sociology of risk. The early cultural approach argues that while risks are real, they are socially constructed by the particular configuration of a society with its members and external factors. Chiefly, how risks are selected and prioritized is politicalization of risks achieved by key institutions in the society.

From the radical constructivist perspective of governmentality and systems theory, we deduce that risks are not created, they are manufactured and proliferation of risks can serve very different purposes than what appears on the surface. Objective probability and statistics is applied to create a new field of knowledge and specialists which have more power than other laymen. This 'bio-politics' quantifies calamities and individuals into age, happiness, gender, health status, frequency and severity and in the process creates a powerful system of governing, controlling and surveying the population. In this surveillance society, growing concerns about risk are not a result of the quality of risk or a specific culture but of how the liberal societies are actually governed.

Systems theory pictures society as existing in its communications and so risk is a way of communication and discovering for the agents in the society. There is conflict based framework of society and social risks arise because some groups create and divert risks to other parties as

¹ Zinn, O. J. University of Melbourne "The sociology of risk and uncertainty – current state and Perspectives".

externalities to avoid any blame or reprehension. Gains are however privatized and remains within the powerful groups. Systems theory sees growing risk communication as a result of ongoing economic inequality and societal differentiation, which fuels negotiations about who is responsible for undesired societal events and increases chances and sharpness of direct confrontations. (Luhmann 1993; Japp and Kusche 2008).

Finally, Beck emphasizes that new risks are increasingly threatening modern civilization. Aside from natural catastrophes, man-made manufactured risks are now larger than ever before and it is becoming extremely hard to even quantify their impacts.

As can be seen, the governmentality approach can be seen as very relevant to actuarial practices. It is argued that group differences created by historical processes of domination are demoralized by actuarial representations (as they are for instance in insurance premium setting) it becomes more difficult for disadvantaged groups to generate political power. This is because sensitive stratifications like gender, credit profiles and pricing elasticities etc are living realities of the people whereas in classification for actuarial ratemaking, they are stripped off their subjectivities and transformed into an objective formal reality. The moral charge carried by these forms of differences are eliminated and so actuarial ratemaking classification “with its de-centered subject, seems to eliminate, in advance, the possibility of identity, of critical self-consciousness and of intersubjectivity (cf. Habermas, 1979). Rather than making people up, actuarial practices unmake them.”

Data derivatives²

Data derivatives are combination of vast data and learning correlations and association rules from it. This leads us not to certainties but to probabilities and yet the practical impact is that we decide our precautions based on result from these data derivatives to sustain in face of ever emerging and increasing risks. Data derivatives drives pre-emption not by predicting the future but by projecting fragments of data onto possible futures, producing a form of encoded intuition. As the associations are ephemeral, time sensitive, only correlated and do not show causation, it practically feels like calculated gambling. This is why it is termed ‘derivative’ of data as it is clear that data derivative emerges from the practices of speculative business like from the realms of derivatives trading and expands into other realms by proliferation of data science.

Sociology of Life Insurance³

Sociology of life insurance is very interesting because it seems so absurd, historically that people will accept the sacred time and event of death as a chance to earn money and security. As XYZ says: “With life insurance, man and money, the sacred and the profane, were thrown together. Life insurance threatened the sanctity of life by pricing it. In the earlier part of the 19th century, the

² Amooore, L.A. (2011) ‘Data derivatives: on the emergence of a security risk calculus for our times.’ Theory, culture society. 28 (6). pp. 24-43.

³ Zelizer, A. V. The American Journal of Sociology, Volume 84, No. 3(Nov 1978) pages 591-610 Human Values and the Market: The Case of Life Insurance and Death in 19th Century America.

American public was not ready to commercialize death. Life insurance was rejected as a sacrilegious enterprise.”

Life insurance was a business like any other with profit maximization as its main reason for existence. However, the profit justification seemed too base for an institution of its kind which deals with such sensitive, sacred product of death over a very long term. Given these circumstances, how did life insurance become common in our modern societies and overcame the resistance to such an initiative?

Two chief historical reasons can be sociologically deduced from analysis of historical documents and trends. The first is that life insurance responded by playing ‘fire with fire’; as they were seen as un-religious by trying to commoditize death, they in fact created and assert their own religious image of following core ethics and becoming missionaries of the religion of capitalism. Second reason was aggressive marketing strategy of agents selling life insurance as ‘life insurance is sold and not bought’.

It is widely held that the rapid expansion of capitalism from 19th century and onwards created its own secular religion by numerous ways. It created possibility of emancipation by hard work and saving capital to accumulate capital, rituals were routines based on office timings, ethics were of hard work and repaying debts at due dates with capital as the sovereign overlord. Life insurance seized on this core change and disguised its material ambitions in spiritual garb. The company and its employees were projected as trust worthy ethical and life-long partners of the policyholders with concerns of policyholders as their foremost criteria. Life insurance was portrayed as a social good in capitalism as death will now not lead to insecurity or poverty to those affected. As Zelizer continues “Indeed, by the latter part of the 19th century, when American business felt sufficiently confident to seek no other justification than the wealth it produced, life insurance still retained part of its religious camouflage. Even some of the most hard-bitten business leaders of the industry slipped into sentimentalism in speaking of life insurance as a “conviction first and then a business” (Kingsley 1911, p. 13).”

Secondly, the distinctive and vital role of the agent in life insurance was a response to powerful client resistance. Persuasive and persistent personal solicitation alone could break through the ideological and superstitious barriers of the public against insuring life.” While the companies trained the agents to market themselves to consumers as above materialistic concerns and showcase their ethics and tasks with missionary-level spiritual devotion, the highest rewards went to the successful salesman who sold the most policies.

Philosophy in Insurance

These are perspective-changing and incredibly invaluable excerpts from the essay 'insurance and risk' by the philosopher Francois Ewald⁴. In the end, terrorism extract is given. In few pages Francois is gracefully able to explain the underlying mechanisms that take a whole life to experience and realize.

“Insurance designates not so much a concept as an abstract technology. Using the vocabulary of the nineteenth-century actuaries, economists and publicists, we can say that the technology of insurance is an art of 'combinations'. Not that insurance is itself a combination, but it is something which, on the basis of a technology of risk, makes possible a range of insurance combinations shaped to suit their assigned function and intended utility-effect. Considered as a technology, insurance is an art of combining various elements of economic and social reality according to a set of specific rules.

The particular form insurance technology takes in a given institution at a given moment depends on an insurantal imaginary: that is to say, on the ways in which, in a given social context, profitable, useful and necessary uses can be found for insurance technology. Thus, the birth of social insurance at the end of the nineteenth century needs Insurance technology and actuarial science did not fall from the mathematical skies to incarnate themselves in institutions. They were built up gradually out of multiple practices which they reflected and rationalized, practices of which they were more effects than causes, and it would be wrong to imagine that they have now assumed a definite shape.

Insurance can be defined as a technology of risk. As a technology of risk, insurance is first and foremost a schema of rationality, a way of breaking down, rearranging, ordering certain elements of reality. The expression 'taking risks', used to characterize the spirit of enterprise, derives from the application of this type of calculus to economic and financial affairs.

Rather than with the notions of danger and peril, the notion of risk goes together with those of chance, hazard, probability, eventuality or randomness on the one hand, and those of loss or damage on the other - the two series coming together in the notion of accident.

The insurer's activity is not just a matter of passively registering the existence of risks, and then offering guarantees against them. He 'produces risks, he makes risks appear where each person had hitherto felt obliged to submit resignedly to the blows of fortune. It is characteristic of insurance that it constitutes a certain type of objectivity, giving certain familiar events a kind of reality which alters their nature. By objectivizing certain events as risks, insurance can invert their meanings: it can make what was previously an obstacle into a possibility. Insurance assigns a new mode of existence to previously dreaded events; it creates value:

Insurance is one of those practices linked to what Pascal called the 'geometry of hazard' or 'algebra of chances' and is today called the calculus of probabilities.

⁴ Francois Ewald; *The Foucault Effect; studies in Governmentality*, University of Chicago Press (1991).
Essay pgs 197 to 211: “Insurance and Risk”

The mutualities created by insurance have special characteristics: they are abstract mutualities, unlike the qualitative mutualities of the family, the corporation, the union, the commune. One 'belongs' to the latter kinds of mutuality to the extent that one respects their particular duties, hierarchies, orderings. The family has its rules, the trade union its internal regulations. These mutualities place one, moralize one, educate one, form one's conscience. Insurance mutualities are different: they leave the person free. Insurance provides a form of association which combines a maximum of socialization with a maximum of individualization. It allows people to enjoy the advantages of association while still leaving them free to exist as individuals. It seems to reconcile those two antagonists, society-socialization and individual liberty. This, as we will see, is what makes for its political success.

Insurance does not, as has been mistakenly said, eliminate chance, but it fixes its scope; it does not abolish loss, but ensures that loss, by being shared, is not felt. Insurance is the mechanism through which this sharing is operated. It modifies the incidence of loss, diverting it from the individual to the community. It substitutes a relation of extension for a relation of intensity.?

As Proudhon explained:

The savings bank, mutuality and life assurance are excellent things for those who enjoy a certain comfort and wish to safeguard it, but they remain quite fruitless, not to say inaccessible, for the poorer classes. Security is a commodity bought like any other: and as its rate of tariff falls in proportion not with the misery of the buyer but with the magnitude of the amount he insures, insurance proves itself a new privilege for the rich and a cruel irony for the poor.

Insurance possesses several distinct dimensions of technique. In the first place, it is an economic and financial technique.

Secondly, insurance is a moral technology. To calculate a risk is to master time, to discipline the future. To conduct one's life in the manner of an enterprise indeed begins in the eighteenth century to be a definition of a morality whose cardinal virtue is providence. To provide for the future does not just mean not living from day to day and arming oneself against ill fortune, but also mathematizing one's commitments. Above all, it means no longer resigning oneself to the decrees of providence and the blows of fate, but instead transforming one's relationships with nature, the world and God so that, even in misfortune, one retains responsibility for one's affairs by possessing the means to repair its effects.

Behind this problem of guarantees there lies another, profounder one, namely the problem of the permanence of insurance institutions. Since they are supposed to be providing security, these need to have a quasi-infinite longevity. With insurance one comes to experience a sort of dilation of timescales, stretched out to span not just one generation or lifetime but several, and thus positing the survival of society for an indefinite future. One moves from a limited conception of time bound to the life of individuals, to a social time measured against the life of society, actualizing the Comtian conception of progress which founds the idea of solidarity as formulated in the political theory of solidarisme. In guaranteeing security, the state is equally guaranteeing itself its own existence, maintenance, permanence. Social insurance is also an insurance against revolutions."

Selected excerpt from terrorism insurance by Aradau et al are:⁵

“What interests us is not so much these technologies per se, but rather what political imaginary makes them possible and what political imaginary they enact. Insurance starts by classifying and objectifying phenomena in order to be able to calculate the degree of chance or risk. Insurance has its own science, actuarialism, which claims to be able to assess risks in order to commodify them (Ericson et al., 2003: 8). The first imperative of insurance is to define. The insurance industry needs to define terrorism, create a calculable rendering of terrorism and constitute the subject who is to be insured. For even when the mathematical calculus of probability finds itself surpassed by catastrophic events and other means of governing more akin to the game model are proposed, insurance still relies upon classifications and definitions of what and who is to be insured. The other imperative of insurance is to represent the future and its relation to the present. In attempting to neutralize or even prevent the possibility of ‘dangerous irruptions’ (Castel, 1991) in the future, insurance also colonizes the future.”

⁵ Aradau, Claudia and van Munster, Rens (2008). Insuring terrorism, assuring subjects, ensuring normality: the politics of risk after 9/11. *Alternatives: Global, Local, Political*, 33(2) pp. 191–210.

Sociology of finance

Introduction

Emmanuel Derman, a leading quant, advocates that there is enough mathematics in finance already; what we need is imagination.⁶ Perhaps this void can be filled by sociology of finance.

Sociology of finance is defined as “the systematic study of financial markets and transactions from a sociological perspective. The goal is to develop a rich and in-depth understanding of the financial markets from an interdisciplinary perspective.”⁷

Many disciplines and professions other than sociology can gain from a better understanding of social aspects of finance such as those in the economics and finance fields. The aim of this report is to investigate various sociological ideas, concepts and applications to finance. These areas are quite broad, distinct from each other but it is imperative to discuss these so as to have an in depth understanding of the various paradigms of sociology of finance. These concepts are grouped in the following sections in this report;

1. Cultural construction of finance
2. The social-constructive cognitions of financial analysts
3. Financial engineering and the financial crisis

Cultural constructions of finance

Cultural construction As per Suttles linguistic research on the use of the word ‘economy’, Suttles discovers that the modern usage of the word ‘economy’ as a system of exchange, production and consumption was not existent in 1929 crisis and only assumed its modern usage when Keynes introduced it in 1934. The 1929 crises was seen as a crises in business, not the economy and the social metaphor used to describe it was ‘business’ (instead of economy) which was a natural occurring activity which was self-correcting but sometimes sick as well. Over the next few decades this metaphor changed and now the economy was viewed as a ‘grand machine’ that can be controlled by social engineering of economic and social policies. By 1987 and onwards, embezzlements, shady products, deregulation, massive innovation in products and technology meant that the economy had become a ‘casino’.⁸

Starting from 2008 financial crises and onwards, economy is primarily thought of as a computer network or information system. The *viruses* of default *freezes* credit and spread throughout global *networks* which *crashes* the economy.⁹ These metaphors increasingly bring the fragility and vulnerability of the economy onto the surface to make us realize that we live in a ‘risk society’

⁶ Big Think. <http://bigthink.com/think-tank/theres-enough-math-in-finance-already-whats-missing-is-imagination>

⁷ [Lexicon; Financial Times](#)

⁸ Suttles, G. with Jacobs, M. D. (2010). *Front Page Economics*. Chicago: University of Chicago Press.

⁹ *Ibid*

(Ulrich Beck) where risk is globally being created and leads to massive scales of crashes in the economy.¹⁰

These shifts in the core metaphors point towards ideological shifts. Such shifts occur most abundantly in times of crises where uncertainty reigns supreme and institutional guides to behavior are no longer relevant. It is in such times that metaphors pack the uncertainties in a symbolic manner to guide the people like a map in an unknown territory.¹¹

Financial crises are also symbolic and ritual events. Financial crises arise with an apocalyptic anxiety that something we never predicted happened and is causing the end of our world as we know it. Over time, this initial anxiety transforms into passiveness of 'learned helplessness' (Martin Seligman¹²) which teaches us that we have no control over these external torments and this leads to pessimistic outlook of the society at that point in time. There is also 'atoning' or repenting where the public rage over accountability forces the parties responsible to at least acknowledge their role in the crises and what they did wrong.¹³

Another key concept in sociology of finance is time-space compression. Due to globalization in the post-modern era, we continuously face 'time-space compression' in finance. This refers to increasing capacity of capital to be available and transmitted across geographical barriers within moments and not delayed by time. This has been brought possible by globalization and technological advances. But this bridging of time and space has proceeded in a highly unequal manner. As time-space compression increases the power of global capital centers like Wall Street and city of London, others offering fewer opportunities for profit have continuously found themselves pushed further away in relative economic continuum.¹⁴

Time space compression along with other social trends towards polarization means that there is not just increasing economic inequality but also social and cultural differentiation. Oxfam officially showed that now top 1% own more than the remaining 99%.¹⁵ We also have historically high gini coefficient which is a metric for measuring economic inequality. We are witnessing the development of differential modes of treatment of populations, which aim to maximize the returns on doing what is profitable and to marginalize the unprofitable. Instead of segregating and eliminating undesirable elements from the social body, or reintegrating them more or less forcibly through corrective or therapeutic interventions, the emerging tendency is to assign different social destinies to individuals in line with their varying capacity to live up to the requirements of competitiveness and profitability.

¹⁰ Ulrich Beck (2009); *Towards a New Modernity*

¹¹ Mark D. Jacobs, 17th May, 2012: *Oxford Handbook of Sociology of Finance*, chapter 19: Financial crises as symbols and rituals

¹² Seligman, M. E. P. (1972). "Learned helplessness". *Annual Review of Medicine* 23 (1): 407–412.

¹³ Emile Durkheim; 1912, 1995: *The elementary forms of the religious life*

¹⁴ French and Leyshon, 17th May, 2012: *Oxford Handbook of Sociology of Finance*, chapter 18: Dead pledges; mortgaging time and space.

¹⁵ BBC News; Jan 2016. Oxfam says wealth of richest 1% equal to other 99%

Taken to its extreme, this yields the model of a 'dual' or 'two-speed' society recently proposed by certain French ideologists: the coexistence of hyper-competitive sectors obedient to the harshest requirements of economic rationality (we can see this today in P & C sector), and marginal activities that provide a refuge (or a dump; social impact bonds; rising charity initiatives all over the world etc) for those unable to take part in the circuits of intensive exchange. In one sense this 'dual' society already exists in the form of unemployment, marginalized youth, the unofficial economy. But until now these processes of disqualification and reclassification have gone on in a blind fashion. They have been uncontrolled effects of the mechanisms of economic competition, underemployment, adaptation or non-adaptation to new jobs, the hemorrhaging of the educational system, etc. The attempts which have been made to reset these processes are more addressed to infrastructures than to people: industrial concentration, new investment sectors, closures of non-competitive concerns, etc. - leaving their personnel to adjust as well they may, which often means not particularly well, to these 'objective' exigencies.¹⁶

The social-constructive cognitions of financial analysts

Financial analysts are conceptualized in sociology of finance as organizational and institutional agents. They regularly maintain hegemonic categories for valuation of financial entities focusing primarily on shareholder value perspective.¹⁷

The core process of valuation of fundamentals for equities is to estimate some value indicator for the concerned company and relate this indicator to the market price. The difference between such fundamental value and market value then reflects whether the company according to the analyst is over-valued or undervalued.¹⁸

Aside from a micro-company wise analysis, whole markets and sub markets are also analyzed to forecast the valuation dynamics of whole markets. Why is such analysis undertaken? This is because analysts recognize that market prices can and do swing far away from fundamental valuations over long term as well (and not only short term). This is due to a number of sociological workings in the financial markets. Analysts recognize the limits of our rationality and the asymmetry of information. Not everyone is an equal participant in the market and the spotlight is always fixed upon the market movers, the deep pocketed investors that seek alpha returns and create a path for market followers to follow through index tracking. Another important concept, long discussed by philosophers and sociologists is that of reflexivity. Reflexivity says that we are not just micro agents subject to an all-powerful macro market. While the market does lead to individual action, a collection of individual action, thinking and biases can also change the market and the fundamentals that assist in determining the market prices itself.¹⁹

¹⁶ Francois Ewald. Connecticut Insurance Law Journal. Volume 6:2. Risk In Contemporary Society

¹⁷ Leon Wansleben, 17th May, 2012: Oxford Handbook of Sociology of Finance, chapter 13: Financial analysts.

¹⁸ Hooke, J. C. (2010). *Security Analysis and Business Valuation on Wall Street: A Comprehensive Guide to Today's Valuation Methods* (2nd edn). Hoboken, NJ: Wiley

¹⁹ The Alchemy of Finance: Reading the mind of the Market (1987) by George Soros, pg 27-45

As a result of these asymmetries, a core suite of analysis is ‘comparative’ and ‘precedent’ analysis which goes on to show that analysts continuously observe each other. Moreover, the use of term ‘market expectations’ highlight the analysts’ consensus prominently. These consensus are published by specialized information providers such as Bloomberg and Reuters regularly.

These consensus are utilized by analysts both when homogenizing their forecasts with these as well as when differentiating their forecasts with regard to the consensus. These consensus are used as an ‘anchor’ to situate their forecasts in context of the market as well as to identify market surprises because of some factors that the consensus have under-valued or ignored. These surprised divergences from the market view are based mostly on fast and frugal heuristics.²⁰

Due to multiple irrational factors in work, a tension or ‘cognitive dissonance’ is created between the cognitive anticipations of the analysts on how market prices really work and the ‘fair’ fundamental value of equity. This tension is managed by differentiating the short term basis from the long term outlook. Long term outlook is treated as quite differently than short term on the belief of mean reversion which is that in the long term, values will converge to the fundamental values.²¹

Aside from technically seeing market objectively, storytelling is also central to the practices of analysts. Selective drawing on qualitative as well as quantitative information in modeling and in their narrative is developed in order to tell a story about the company to investors and other parties involved with less technical aptitude. The stories are a logical progression that aims to make sense and is vital as they absorb differing, heterogeneous, irrational, intuitive information, connect the various dots such as connecting past and expected future with the present, and are explainable in common sense manner to other investors. These stories facilitate analysts communications with clients, arouse and influence trading and increase status differentiation within the various levels of community of the analysts.²²

But these sociological elements underpinning daily realities of analysts are not without its drawbacks. The analyst consensus can lead to withering away of the diversification benefit as if many traders lead a similar position on the market, the elements in the variance-covariance matrix that are uncorrelated or weakly correlated can suddenly become highly linked. This is what caused LTCM’s diversification to fail in the first place as many other traders took on same or similar positions as LTCM was viewed as a winner. These consensus can and do play their role in perpetuating herding behavior and group think where too many similar thoughts and actions lead to a boom or a bust in the financial markets.

Financial engineering and the financial crisis

Finance as per sociology is studied as a ‘field’ of markets, government, firms and financial products. The field concept recognizes that these elements take each other into account and are interconnected. This way of looking at finance like a field enables a holistic view that can potentially peak into the bigger picture involved.

²⁰ Chambost, I. (2010). “The Consensus of Security Analysts: An Institutionalized Cognitive Artifact.”

²¹ Leon Wansleben, 17th May, 2012: Oxford Handbook of Sociology of Finance, chapter 13: Financial analysts.

²² Ibid

The social context to proliferation of advanced financial engineering theories can be holistically elaborated. The first wave of developments in modern portfolio theory concerned itself with re-affirming investment practices and wisdom, such as know your business, do not put all your eggs in one basket etc, using mathematical language. Theories such as those of Markowitz and Roy, and Modigliani and Miller are instances of this wave.²³

The second wave was more ambitious. A deeper economic context was added to the mathematics to devise new theories which portray a discrete jump over the first wave which was created mainly to validate existing investment practices in order to increase penetration of financial engineering to the business and investment communities. Efficient market hypothesis and Capital Asset Pricing Model fit the bill for this wave.²⁴

Amidst this wave, a number of macro-economic changes ushered that led to increased demand for financial engineering. Fall of Dollar from the gold standard in 1971, high inflation, and fluctuations in commodities lead to rampant volatilities in the financial markets. This is when the Black-Scholes formulation of valuing contingent payoffs made it into the lime light as a way to price derivatives that were increasingly used to hedge against these volatilities. Ironically, the very instruments made to reduce risk lead to a financial meltdown due to the institutional manipulation of such products.

But these financial models over time did not just describe the models, they transformed them as well. Owing to the huge importance these financial models gathered in the markets, they were now creating reflexivity by transforming markets after their own images.²⁵

Derivatives such as modeling-intensive Mortgage Backed Securities and Credit Default Swaps are widely credited with being one of the main reasons for the financial crises of 2008. It was believed that these allowed for widespread diversification of risks, whereas the financial crises showed that it did not lead to diversification of risk as much as its wholesale transfer to others. It was the confounding modeling complexity surrounding these contingent cashflows of MBS and CDS that meant that no one properly understood them and it enabled the transformation of even the riskiest of mortgages into investment grade securities.²⁶

While this is true, the explosion of these instruments around nonconventional mortgage securitization was also, at its core, a product of the structure of sociological relations between firms and the state in the market. Even though quants were used to justify MBS, MBS were not made by quants themselves. This central feature of all MBSs was thus not the creation of financial economists but employees of financial firms who were trying to overcome the objections of potential customers

²³ Frank Jovanovic, 17th May, 2012: Oxford Handbook of Sociology of Finance, chapter 28: Finance in modern economic thought

²⁴ Ibid

²⁵ MacKenzie, D. A. (2006). *An Engine, Not a Camera: How Financial Models Shape Markets*. Cambridge, MA: MIT Press.

²⁶ Beachy December 2012: A financial crisis manual; Tufts University

to buying bonds.²⁷ By focusing primarily on the innovative financial instruments themselves, we miss the context in which these instruments emerge and assume importance.

The banking strategy over time shifted from long term retail basis to fees-generating model for revenues. MBS were highly profitable as well as large in size which allowed for massive fees to be generated. Couple this with increase in leverage being used to further increase profits, and mortgages sold even to the riskiest of customers to increase revenue, MBS were utilized to further institutional greed. Also the fact that regulations barred the Government state entities from issuing and guaranteeing these risky subprime MBS, an alternative means to issue security and make the investors comfortable with these products had to be devised. Here is where the quants figure in. Quants with their complex statistical models and authoritative scientific feel replaced the traditional government guarantees to convince risk-averse investors to buy these products.²⁸

No matter how aggressively the banks tried to model financial markets and products, they had shortcoming in their assumptions and on the fact that no business is separate from its market context and realities. Thus even the most sought after models such as Value at Risk, Black Scholes etc broke in face of risky bad marketing and selling. All models that previously gave solid results melted into air.

Government was also complacent in a number of ways as a religious and almost fanatic belief over the efficient markets hypothesis stifled any initiative to increase regulation (Noam Chomsky²⁹). Secondly government was always few steps behind the product innovations and market trends. Alan Greenspan famously testified before Congress that he did nothing to halt the rapid growth in subprime mortgages as he believed that the banks would not have given the loans if they were deemed to be too risky.³⁰ Such thinking reflects undue belief in the capacity of markets to be self-correcting.

²⁷ Fligstein and Goldstein, 17th May, 2012: Oxford Handbook of Sociology of Finance, chapter 17; A long strange trip: the state and mortgage securitization, 1968-2010

²⁸ Ibid

²⁹ [Noam Chomsky, 10th Feb 2010; Foreign policy in focus; Chomsky: understanding the crisis- markets, the state and hypocrisy](#)

³⁰ [NY Times, Andrews, 23rd October 2008: Greenspan concedes error on regulation](#)

Conclusion

To summarize, we looked briefly at how finance is culturally constructed. We also elaborated on the micro choices financial analysts make in part of their daily lives in the hegemonic structure as well as seeing toxic structured products in their proper social context. We also covered various areas of sociology of risk and presented life insurance in its proper social context.