Comment on Dan Awrey's *Hardwired Conflicts: The Big Bang Protocol, Libor and the Paradox of Private Ordering*

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Core Argument

Broad Claim

- "Market structure" can operate as a barrier to entry, protecting the privilege of a core group who are, therefore, unwilling to change the system.
- Failure to change the system can lead to major shocks, undermining stability.
- "The paradox of private ordering."

Case Studies

- As currently structured, the Determination Committee (DC) mechanism of the Big Bang reform is a very bad idea.
  - Its design parallels the way BBA set LIBOR.
  - Therefore the DC mechanism should be reformed.
- Both of these (DC and LIBOR) illustrate the paradox of private ordering.

Causation

- “Market structure” and market power.
  - “institutional arrangements which lower information, coordination, agency, contracting and/or other transaction costs”
  - Standardization as an anti-competitive practice.
    - But doesn’t standardization make entrance easier?
    - Insurance markets v. derivatives markets.
- Is market structure a cause of market power or an effect of market power?

Causation

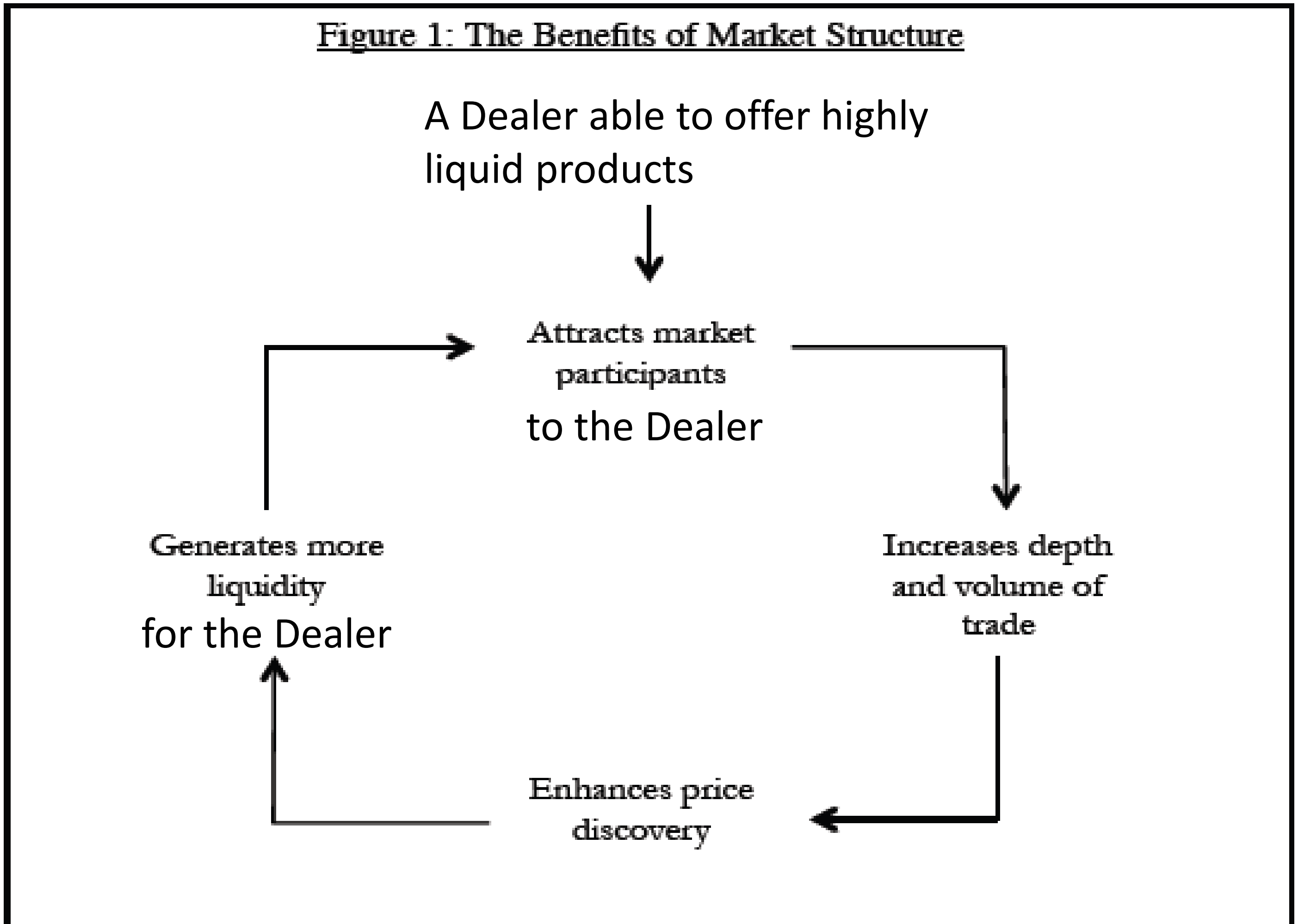
Figure 1: The Benefits of Market Structure
A Dealer able to offer highly liquid products
Attracts market participants to the Dealer
Increases depth and volume of trade
Enhances price discovery
Generates more liquidity for the Dealer

Change

- Market structures <u>do</u> change. E.g., ISDA standard documentation and the Big Bang Protocol itself.
- What causes these changes?
- What kinds of change is the core willing to contemplate?
  - Focusing on power of core, perhaps shocks where these institutions (fully) internalize costs.
    - Not bets where core dealers can expect a bailout (moral hazard).
  - Would a focus on these dynamics give us a sense of when we ought to be most concerned about market structure?

Dan’s “bespoke solution”

1. DC members disclose trading positions in any reference obligation.
2. DC members disclose conflicts and recuse themselves or be subject to a removal mechanism.
3. Impose trading restrictions on DC members w/r/t obligations under consideration.
4. Replace dealer DC members with outside experts.