

Contents

Preface	xiii
Acknowledgments	xix
Introduction	1
PART ONE	
The Crises That Led to Derivatives Reform	15
CHAPTER 1	
Seven Causes of the 2008 Market Crises	17
Ignoring the Warning Signs	18
More than Seven Causes of the 2008 Market Crises	20
An Incomplete Response to Problems Exposed in the Enron Bankruptcy	26
Enron Finance Used by Banks and the Lack of Regulation	29
The Absence of Effective Regulation	30
The Shadow Banking System	34
Development of an Unregulated Global Derivatives Market	39
The Rise of Credit Derivatives and the Credit Default Swap	44
Private-Label Residential Mortgage-Backed Securitization	45
U.S. Policy Fostering Home Ownership and GSE Mismanagement	47
Derivatives and Structured Products Accounting Practices	49
Notes	52
CHAPTER 2	
The Crises and Reform Timeline	55
March 17, 2008: Bear Stearns Is Sold	57
March 27, 2008: Barack Obama Introduces Reform Principles	58

September 15, 2008: A Bankrupt Lehman Brothers	59
November 2008 to January 2009: American Leadership Ascends	60
March 26, 2009: Geithner Provides Testimony to Congress on Reform	60
May 13, 2009: Geithner Writes a Letter to Harry Reid	61
June 2, 2009: An Early Voice Speaks Out against the Clearing Mandate	61
June 22, 2009: American Corporations Lobby against Central Clearing Mandates for OTC Derivatives	62
July 22, 2009: Introduction of Legislation Favoring Exemptions to the Clearing Mandate	62
July 30, 2009: Introduction of Broad Outlines of the New Law	63
September 8, 2009: The Industry Demonstrates Commitment to Centralized Clearing	63
October 2, 2009: House Releases Draft of OTC Derivative Legislation	63
November 11, 2009: Senate Releases Draft of OTC Derivative Legislation	64
December 11, 2009: House Passes the Wall Street Reform and Consumer Protection Act of 2009	64
January 1, 2010: The New York Fed Publishes <i>The Policy Perspectives on OTC Derivatives Market Structure</i>	65
April 7, 2010: Financial Crisis Inquiry Commission Begins Hearings	65
April 16, 2010: Senator Lincoln Introduces the Wall Street Transparency and Accountability Act of 2010	66
April 22, 2010: President Obama Returns to Cooper Union to Speak on Reform	66
April 26 to 27, 2010: Senate Votes to Delay Debate on Derivatives Reform	67
April 27, 2010: The Goldman Hearing	67
April 28, 2010: Senate Votes Again to Proceed with Financial Services Reform	70
May 20, 2010: Senate Passes Its Version of the Legislation	70
June 30, 2010 and July 15, 2010: Congress Approves Legislation and Seeks the President's Approval	71
July 21, 2010: President Obama Signs Dodd-Frank into Law	71
U.S. Rule Making in 2010 and 2011	73
U.S. Reform Blazes the Trail for Global Derivatives Reform	79
Notes	80

PART TWO**Derivatives Reform****83**

Introduction to Part Two

83

CHAPTER 3**Introduction to Futures, Margin, and Central Clearing****85**

Three Crises and the Need for the Futures Model

87

A Brief History of Futures Contracts and Markets

92

The Commodity Futures Modernization Act of 2000

98

Introduction to the Futures Model and Basic Futures Concepts

100

Regulation of Futures

112

A Futures Contract in Action

114

Default by a Clearing Member in the Futures Model

117

Global Reform and the Futures Model

120

Notes

126

CHAPTER 4**U.S. Derivatives Law in Title VII of Dodd-Frank****131**

Organization of Dodd-Frank

131

Introduction to Titles VII and VIII

134

The Approach to Understanding New Derivatives Law
in the United States

136

Products

137

People

147

Taxpayers

153

Whistleblowers

169

Platforms

170

Notes

175

CHAPTER 5**Title VIII of Dodd-Frank****177**

Opposition to Title VIII

178

Before Title VIII

180

What Exactly Does Title VIII Set into Motion and When?

182

What Is a Systemically Important Activity?

183

Practical Results of the New Law

184

Notes

186

CHAPTER 6**A Primer on Legal Documentation****187**

Background

190

“Let’s Use an ISDA”

191

History of the ISDA	194
Basic OTC Architecture	195
The ISDA Documentation in Practice, and Problems in 2008	202
Glossary	208
Notes	210

CHAPTER 7

The Life Cycle of a Cleared Derivatives Trade	211
Step One: Legal Documentation	211
Step Two: Trade Execution via an SEF, SB-SEF, or DCM	215
Step Three: Alleging and Affirming a Trade; Reporting in Real Time	221
Step Four: The FCM Take-Up	222
Step Five: Trade Is Centrally Cleared	223
Step Six: The Trade Is Reported for the Second Time	225
Notes	226

PART THREE

Trading Before and After Reform	227
--	------------

CHAPTER 8

The History of Derivatives and Futures	229
The Earliest Derivative	230
Trees, Forests, and Wildfires	231
Did They Exist in Antiquity?	233
OTC and Exchange Derivatives	233
Back to Biblical Times	234
The Dark Ages and Medieval Europe	239
The Muslim Empire	240
Development and Early Use of the Bill of Trade or Exchange	241
After the Protestant Reformation	244
An Early Sighting of the Term <i>Commodity Pools</i>	249
Ten Wise Men	250
The Modern Era Begins in the States in 1848	258
Early-Twentieth-Century America	259
1907 Bankers Panic	260
S&Ls and Mortgage Finance Functions Well Before Abuses	268
The Creation of Fannie and Freddie	268
Disco, Dealers, Swaps, and Redlining in the 1970s	269
U.S. Regulators Formally Recognize Swaps	273
The Birth of the OTC Market	274

Contents

xi

The Evolution of Options Markets	275
The Futures Trading and Practices Act and the 1993 Swaps Exemption	276
ISDA	277
The 1987 Crash and 1990s Crises	279
The Commodity Futures Modernization Act of 2000	286
Enron Loophole	287
The First Decade of the Twenty-First Century	288
Notes	289
CHAPTER 9	
Market Structure Before and After 2010	299
Ancient Commodity Markets	299
Earliest Modern Exchanges	300
The Great Depression and Bucket Shops	301
Open Outcry and Pits Give Way to the Machines	302
Reform of U.S. Market Structure	305
Derivative Clearing Organizations (DCOs)	307
Swap Data Repository	308
Market Participants in the OTC Derivatives Trade	309
Notes	311
PART FOUR	
Continuing Education	315
CHAPTER 10	
Survey of Derivatives	317
Overview of the Strategies and Trade Structure	319
Early Derivatives and the Beginnings of the OTC Market	320
Forwards versus Options	320
Option Basics	322
Options Pricing	324
Basic Option Strategies	326
Exchange-Traded Options	328
Swaps Follow Options in the Evolution of Derivatives	329
Credit Derivatives	330
Credit-Linked Notes and Other Securities	336
Total Return Swaps	336
Interest Rate Swaps	338
Equity Swaps	340
Currency Derivatives	341

Property Derivatives	342
Commodity Derivatives	344
Energy Swaps	345
Structured Products, Securitization, CDOs, and CDOs Squared	346
Exchange-Traded Derivatives: Futures and Other Listed Products	348
Additional Resources	349
Online Resources	349
Glossaries	350
Notes	350
About the Author	351
Index	353

<http://www.pbookshop.com>