

## DERIVATIVES LAW SYLLABUS, FALL 2016

**Gary E. Kalbaugh**  
**Classroom: [TBD]**  
**6:10 PM – 8:00 PM**  
**Gary.E.Kalbaugh@hofstra.edu**

**Purpose of the Course:** The purpose of this course is to teach the current law and practice regarding the documentation, negotiation, regulation and enforcement of derivatives and other related financial products. Subjects covered include: (i) the Commodity Exchange Act's regulatory regime for commodity futures, exchange-traded commodity options and foreign exchange; (ii) the swaps regulatory regime imposed by Title VII of the Dodd-Frank Act; (iii) the registration categories of markets, such as designated contract markets and swaps execution facilities, and market participants, such as futures commission merchants, derivatives clearing organizations, swap dealers and major swap participants; (iv) industry standard ISDA Master Agreements; (v) inter-jurisdictional differences in regulation and the extraterritorial application of U.S. regulation; and (vi) enforceability issues in bankruptcy. By the end of the course, you should be familiar with the regulatory regime applying to derivatives and the basics of transactional documentation.

**Course Materials:** Kalbaugh, Derivatives Law and Regulation (Aspen 2014). Other materials will be made available via TWEN or class handouts.

**Classes:** This class (CRN: 94743) is scheduled to meet for two credit hours per week, on Mondays from 6:10 – 8 PM in [TBD].

**Attendance and Preparation:** Students are expected to attend classes regularly and to prepare for classes conscientiously. If you miss class frequently or are unprepared several times, your grade may be lowered. Alternatively, I may ask the Registrar to withdraw you from the course. Sometimes you cannot avoid missing a class. If you know in advance that you will be missing a class for a compelling reason, or if you have missed a class due to illness or emergency, please send me an e-mail, briefly explaining the situation.

**Lateness:** Students are expected to be on time to class. However, it is better to come to class late than not at all. You may walk in late if you have a good reason, as long as you do not abuse this privilege.

**"TWEN" (The West Education Network):** A course page for this class is set-up on TWEN. TWEN gives me a quick way to reach all of you with any announcements, Syllabus changes, handout materials and interesting links. It also gives me a way to extend class discussion beyond the classroom hours.

**Final Grade for the Course:** The course is primarily lecture-based, with a strong emphasis on class participation. The final grade will be derived from the results of a final

exam with the potential for a one-level grade “bump up” for exemplary class participation.

**Final Exam:** The final exam will consist of multiple choice, true/false, and short answer questions.

**Computer Policy:** Computers are to be used during class for taking notes and no other purpose. Violations of this rule may lead to you being prohibited from using a laptop during class.

**Communications:** The best way to communicate with me is by e-mail at the above address. I will get back to you within 24 hours. While I do not maintain regular office hours, if you need to speak with me in person, we can set up an appointment either before or after class or for a telephone call.

### **Summary of Course:**

Due to the dynamic nature of derivatives law and regulation, it may be necessary to update reading materials or to modify class content. Nonetheless, the below is a good guide to the topics we will cover.

#### **Week 1:**        *Introduction to Derivatives*

- What are derivatives and why do we use them?
- The basic building blocks: options, forwards and swaps.
- The economic fundamentals of an interest rate swap and an illustration of “hedging.”
- The legal definition of “swap” in contrast to financial definition.

Required Reading:                Deriv. Law, pp. 1-23.

Recommended Reading:        “Online Learning Guide to Trading Futures” mini-course (visit the website of the National Futures Association and click through the tab for Investor Information until you find the “Online Learning Guide to Trading Futures” and the related mini-course).

#### **Week 2:**        *The Origins of Derivatives Regulation*

- The history of derivatives regulation in the US.
- Origins of the Commodity Exchange Act and Commodity Futures Trading Commission.
- From gambling to hedging, prohibition to laissez-faire economics to regulation.
- The role of the Futures Industry Association and International Swaps and Derivatives Association.

Required Reading: Deriv. Law, pp. 28-62.

Recommended Reading: Deriv. Law, pp. 25-28.

Week 3:      *The Commodity Exchange Act and Commodity Futures Trading Commission*

- The Commodity Exchange Act.
- Jurisdiction: Untangling the Commodity Futures Trading Commission, Securities and Exchange Commission, Department of the Treasury, Federal Energy Regulatory Commission, and the states.
- The Great Divide: Exchange-traded and off-exchange derivatives.

Required Reading: Deriv. Law, pp. 63-86; 90.

Recommended Reading: Deriv. Law, pp. 86-89.

Week 4:      *Contract Markets*

- The operation of boards of trade designated as contract markets or exchanges.
- Regulatory “core principles” as means of oversight.
- Derivatives clearing organizations and their roles with respect to designated contract markets.

Required Reading: Deriv. Law, pp. 91-126

Recommended Reading: None.

Week 5:      *Futures Market Intermediaries*

- Futures commission merchants and their regulation; comparison of futures commission merchants to securities broker-dealers.
- Funds segregation: MF Global and Peregrine as case studies.
- Introducing brokers.
- Floor Brokers.

Required Reading: Deriv. Law, pp. 127-165.

Recommended Reading: None.

Week 6:        *Commodity Investment Vehicles*

- What constitutes a hedge fund?
- Relevance of commodity pools.
- Commodity pool operators and their regulation; absence of securities law analogue.
- Commodity trading advisors and First Amendment issues.

Required Reading:        Deriv. Law, pp. 167-208.

Recommended Reading:    None.

Week 7:        *How Off-Facility Swaps are Documented*

- The role and history of the International Swaps and Derivatives Association (“ISDA”).
- The way derivatives are documented and negotiated: The ISDA Master Agreement, Schedule, Confirmation, Credit Support Annex, Paragraph 13 and Definitions.
- Payment netting and close-out netting with economic examples.

Required Reading:        Sample ISDA Master Agreement, Schedule, and Credit Support Annex.

Recommended Reading:    Deriv. Law, pp. 316-319.

Week 8:        *Negotiating Derivatives*

- *How Off-Facility Swaps are Documented* (continued).
- Negotiating derivatives agreements.
- Review of commonly negotiated clauses in ISDA Schedule and Credit Support Annex.

Required Reading:        Deriv. Law, pp. 314-315; Kalbaugh and Miller, *Master Agreements for OTC Derivatives*, in *Commercial Contracts: Strategies for Drafting and Negotiation* (Vladimir R. Rossman & Morton Moskin, eds., 3d ed., Aspen Publishers 2014) (available on Westlaw at Home > Secondary Sources > Commercial Law Secondary Sources > Commercial Law Texts & Treatises > Commercial Contracts Strategies For Drafting & Negotiating).

Recommended Reading:    None.

Week 9:        *Introduction to the Dodd-Frank Regime*

- Swaps dealers and major swap participants.
- *De minimis* exception to registration.
- Entity-level requirements, e.g., Chief Compliance Officer reports, risk management and capital.
- Central importance of eligible contract participant status.
- Shifting public policy justifications underlying eligible contract participant requirements.
- Swap push-out and the Volcker Rule.
- Margin and capital.

Required Reading:        Deriv. Law, pp. 209-251.

Recommended Reading:    Peruse the Financial Crisis Inquiry Commission Report.

Week 10:       *Transaction-Level Swap Regulations*

- Clearing and on-facility trading requirements.
- The end-user and inter-affiliate exceptions to clearing requirements.
- Clearing designations and available to trade determinations.
- Trade reporting requirements.
- Reporting hierarchies.
- External business conduct requirements.
- “Special entities”.
- Parameters for negotiations and assignment of negotiation pairs.

Required Reading:        Deriv. Law, pp. 253-299.

Recommended Reading:    None.

Week 11:       *Derivatives in Bankruptcy/The Lehman Brothers Experience*

- “Futures” model v. “LSOC” model.
- Bankruptcy for futures and cleared swaps.
- The contractual termination process and the U.S. bankruptcy code.
- The right of “set-off.”
- Overview of the “ipso facto” rule and payment subordination in structured vehicles.
- The “walk away” clause enforceability controversy.
- Section 2(a)(iii) “payment suspension.”
- Modifications to payment priorities.

Required Reading: Deriv. Law, pp. 321-350.

Recommended Reading: None.

Week 12: *Market Manipulation and Enforcement*

- Commodity Exchange Act's criminal provisions.
- CFTC's enforcement authority.
- Fraud in the derivatives marketplaces.
- Market manipulation and its variations.
- Private rights of action.
- Reparations proceedings.

Required Reading: Deriv. Law, pp. 373-443.

Recommended Reading: None.

Week 13: *Cross-Border Issues*

- CFTC's jurisdictional limits.
- Application of futures regulatory regime outside the United States.
- The Dodd-Frank Act's cross-border provisions relation to swaps.

Required Reading: Deriv. Law, pp. 445-457, 462-477 and *Securities Industry and Financial Markets Association v. United States Commodity Futures Trading Commission*, 2014 WL 4629567 (D.D.C. Sept. 16, 2014).

Recommended Reading: *Loginovskaya v. Batratchenko*, 764 F. 3d 266 (2d Cir. 2014).

Week 14: *Wrap-up Discussion.*

Required Reading: N/A (prepare for exam).

Recommended Reading: None.