

FNCE 238/738: Capital Markets
Prof. D. Musto
Course Schedule, updated 8/29/16

This course covers the techniques by which firms go to the capital markets, and the economic issues that arise. As the primary source of funds is debt issuance, the course focuses primarily on the different forms of corporate debt. We analyze the fragility arising from short-term debt, and the mechanisms for defending against it. The key issues that arise with longer-term debt are why and how debt contracts constrain issuers, and the legal and strategic environment of distressed or bankrupt debtors. We cover financing through securitization, starting with the economics of consumer credit, and we address the role of investment intermediaries such as mutual funds. We will also cover shareholder voting and governance, particularly as regards the market for corporate control.

The course is in lecture format, with a 10-15 page note for each class (other than classes with the cases, for which there will be no note). All notes and other course material will be posted on the Canvas site. There is no textbook, but there is a bulkpack. You are advised to read the notes before class, and you are responsible for their content on the tests. The bulkpack readings are for background; you are responsible for their content only to the extent that we discuss it in class. You are generally responsible for the material we discuss in class, whether or not it appears in the notes or other readings. Occasionally I will have a prospectus for students to read before class; you will be responsible for that too.

The assignments to be handed in, on the indicated dates, are

- 6 homeworks; the top 5 of the 6 will count toward your grade
- 4 case write-ups

There are six quizzes, roughly every two weeks starting September 14. As currently scheduled the quiz dates are 9/14, 9/28, 10/12, 10/31, 11/9 and 11/21. **Depending on speaker availability issues that might arise, the dates might change, but the first one will definitely be 9/14.** They will be in-class, taking approximately 30 minutes. In order to account for illnesses, emergencies, interviews and other events that might take you from the classroom, I will count only the top 5 of your 6 scores. **There will be no makeups.** There will be no tests other than these six quizzes, and there will be no final exam.

Homeworks are to be done individually, while the cases are to be done in groups of 3 to 6.

For the final grade, the coursework will be weighted as follows:

- 60% on the top 5 of the 6 quizzes
- 20% on the top 5 of the 6 homeworks
- 20% on the cases

Class participation can help at the margin.

Guest Speakers include Jim Glascott from Barclays, Adam Cohen from Covenant Review, and Steve Collins. On a day with a guest speaker, that talk is the only class of the day. **It is very important to the Wharton School that you attend these presentations if at all possible.** The dates of outside speakers might move, depending on their schedules.

Office Hours and TAs: The TAs are Xingyi Chen, Din Avdic and Jonathan Hartley.

- August 31st **The Treasury Market**
 Basic coupon bond
 Pricing conventions: accrued interest, ytm
 Floating and trading Treasuries; on vs. off-the run
 Simple arbitrage relations
 Short-term risk of long-term arbitrage
 Using Duration
- September 7rd **Financial Fragility**
 Bank runs – Diamond/Dybvig Model
 Defending against bank runs
 Deposit Insurance
 Suspension of Convertibility
 Lender of Last Resort
 Money Funds; Stable NAV and runs
- September 12th **Repos & CP**
HW1, Treasury Pricing, Due
 Basic Repurchase agreement
 Margin, pricing and collateral
 Run on Repo
 Shadow banking
 Tri-Party Repo and recent developments
 Shorting with Repo; Securities Lending
 Commercial Paper Market and Liquidity Facilities
- September 14th **FIRST QUIZ & Market Making**
 Insider trading and the bid/ask spread
 Tactics for trading inside the spread
 Retail trading pathologies
 Payment for order flow
 New trading platforms
- September 19th **Options**
 Put/Call Parity
 One-period Binomial Option Pricing
 Multi-period Binomial Option Pricing
 Valuing default risk as put on firm value
- September 21st **Leverage and Enterprise vs. Shareholder Value**
HW2, Repos, Due
 Fiduciary vs. Contractual duties
 Leverage encourages risk and payouts at the expense of value
 Underinvestment / Debt Overhang
 Contingent Convertibles
 Covenants in practice
- September 26th **Bond Defaults and Amendments**
 Role of Bond Ratings

Events of Default: Financial vs. Technical
Role of Trustee
Consent solicitations

September 28th **SECOND QUIZ & Corporate Bankruptcy**

HW3, Options, Due

Liquidating in Chapter 7

Automatic Stay

Reversal of Preferences / Fraudulent Transfers

Involuntary Filings

Absolute Priority

Reorganizing in Chapter 11

DIP Finance; Super-priority; cram-downs and cram-ups

Voting rules; exclusivity; blocking power

Section 363: asset auctions taking over bankruptcy practice

October 3rd **Financial Distress and Restructuring**

Free-Rider problem

Structuring Exchange Offers: minimum participation; exit consent; threat to file

Prepackaged Bankruptcy

Distressed-Debt Investing

PIPEs

October 5th ***Adam Cohen from Covenant Review, 12pm Only***

October 10th **Cases: LTCM and Breaking the Buck**

October 12th **THIRD QUIZ & Preferred Equity**

Sources of Seniority

Tax and capital-adequacy treatment

Where you see it and where you don't

October 17th Guest speaker on institutional equity trading (tentative)

October 19th **Convertibles**

Standard Convertibles

Floating Price (Death Spiral) Convertibles

Mandatory Convertibles

October 24th **Floating-Rate Products**

Duration

Libor-based products

Clientele

October 26th **Guest Speaker: Jim Glascott from Barclays, 12 and 1:30 only**

October 31st **FOURTH QUIZ / Consumer Credit**
Payment Cards
Mortgages; Fannie & Freddie; basic mechanics
Car loans and other installment loans
Personal bankruptcy: chapters 7 & 13

November 2nd **MBS**
Prepayment risk
Unit of prepayment risk
Sequential tranching
IO/PO; Floaters & Inverse Floaters; PACs & Support bonds

November 7th **ABS**
Managing Credit Risk
Securitizing revolving balances
Ratings

November 9th **FIFTH QUIZ / Mutual Funds**
Open-End Funds
Closed-End Funds
ETFs
Regulatory environment
Performance

November 14th **UNDERWRITING: IPOs, SEOs and Rights Offerings**
HW4, Exchange Offers, Due
Structure of rights offerings
SEOs: traditional / shelf offerings / bought deals
IPOs: mechanism and underpricing

November 16th **Market for Corporate Control**
Corporate voting
Free-rider problem with takeovers
Poison pills / Staggered boards / other defenses
Merger tactics
Important cases

November 21st **SIXTH QUIZ / Credit Default Swaps**
HW5, Equity Offerings, Due
Market Structure
Valuation (roughly)
Settlement after Credit Event
Sovereign CDS

November 28th **TBD**

November 30th **Activist Investing**

December 5th **Guest Speaker: Steve Collins, 1:30 only**

December 7th ***Case: Airgas***

December 12th **Wrapup**
HW6 Due