FNCE 238/738: Capital Markets
Prof. D. Musto
Course Schedule, updated 08/18/17

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 coursepack. You are advised to read the notes before class, and you are responsible for their content on the tests. The coursepack 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
- 3 case write-ups

There are six quizzes, roughly every two weeks starting September 18. As currently scheduled the quiz dates are 9/18, 10/4, 10/18, 10/30, 11/8 and 12/4. **Depending on speaker availability issues that might arise, the dates might change, but the first one will definitely be 9/18.** 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:
- 65% on the top 5 of the 6 quizzes
- 20% on the top 5 of the 6 homeworks
- 15% on the cases

Class participation can help at the margin.

Guest Speakers are Adam Cohen from Covenant Review, Andrew Goldman from Wilmer Hale, Mark Zandi from Moody's Analytics, and one TBA. 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, Sean Egan, Matt Jevsevar and Julia Tolmachyov

August 30th **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 6th **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 11th **The Money Market**
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 13th **Trading and Market Structure**
Insider trading and the bid/ask spread
Tactics for trading inside the spread
Retail trading pathologies
Payment for order flow
New trading platforms

September 18th **FIRST QUIZ & Options I**
Put/Call Parity
One-period Binomial Option Pricing

September 20th **Options II and Shareholders vs. Bondholders**
HW2, Repos, Due
Multi-period Binomial Option Pricing
Capital-Market Securities as options

September 25th **Bond Defaults and Amendments**
Fiduciary vs. Contractual duties
Enterprise vs. Equity Value
Underinvestment / Debt Overhang
Crafting Bond Contracts
Events of Default: Financial vs. Technical; Role of Trustee

September 27th ***Guest Speaker: Adam Cohen, Covenant Review, 3pm only***

October 2nd **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 4th **SECOND QUIZ** & **Financial Distress and Restructuring**
Free-Rider problem
Structuring Exchange Offers: minimum participation; exit consent; threat to file
Prepackaged Bankruptcy
Distressed-Debt Investing
PIPEs

October 9th **Cases: LTCM and Breaking the Buck**

October 11th ***Guest Speaker: Andrew Goldman, Wilmer Hale***

October 16th **Convertibles**
Standard Convertibles
Floating Price (Death Spiral) Convertibles
Mandatory Convertibles
Contingent Convertibles

October 18th **THIRD QUIZ & Preferred Equity**
Sources of Seniority
Tax and capital-adequacy treatment
Where you see it and where you don't

October 23rd **Consumer Credit**
Payment Cards
Mortgages; Fannie & Freddie; basic mechanics
Car loans and other installment loans
Personal bankruptcy: chapters 7 & 13

October 25th **Mutual Funds**
Open-End Funds
Closed-End Funds
ETFs

Regulatory environment
Performance

October 30th **FOURTH QUIZ** / **MBS**
Prepayment risk
Unit of prepayment risk
Sequential tranching

November 1st **ABS and other MBS strategies**
IO/PO; Floaters & Inverse Floaters; PACs & Support bonds
Managing Credit Risk
Securitizing revolving balances

November 6th ***Guest Speaker***

November 8th **FIFTH QUIZ / UNDERWRITING: IPOs, SEOs and Rights Offerings**
Structure of rights offerings
SEOs: traditional / shelf offerings / bought deals
IPOs: mechanism and underpricing

November 13th **Market for Corporate Control**
Corporate voting
Free-rider problem with takeovers
Poison pills / Staggered boards / other defenses

November 15th **Activist Investing**
HW4 Due

November 20th ***Guest Speaker: Mark Zandi, Moody's Analytics, 1:30PM Only***

November 27th ***Municipal Finance***
Tax treatment
Muni instruments
Arbitrage
Muni Distress & Restructuring

November 29th **TBA**
HW5 Due

December 4th **SIXTH QUIZ / Crowdfunding**

December 6th ***Case: Airgas***

December 11th **Wrapup**
HW6 Due