

FNCE 238/738: Capital Markets
Prof. D. Musto
Course Schedule, updated 08/03/18

This course covers the paths firms take 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 we address w/r/t 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 10-20 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 are some readings. You are advised to read the notes before class, and you are responsible for their content on the tests. Any other 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.

The assignments to be handed in, on the indicated dates, are 5 homeworks, the top 4 of which will count toward your grade, and 3 cases. Homeworks are to be done individually, while the cases are to be done in groups of 3 to 6.

There are six quizzes, roughly every two weeks starting September 17. As currently scheduled the quiz dates are 9/17, 10/3, 10/17, 10/31, 11/14 and 12/3. **Depending on speaker availability issues that might arise, the dates might change, but the first one will definitely be 9/17.** 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.

The cases are not traditional cases in the HBS sense. One will involve analyzing a corporate bond prospectus, another will involve analyzing a securitization prospectus, and the third will be analyzing a set of follow-on equity offerings.

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

- 60% on the top 5 of the 6 quizzes
- 20% on the top 4 of the 5 homeworks
- 20% on the cases

Class participation can help at the margin.

Guest Speakers are Adam Cohen from Covenant Review, Andrew Goldman from Wilmer Hale, and one more 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.

Office Hours and TAs: The TAs are Mehran Ebrahimian, James Megibow, Max Hermelin, and 1 more TBA

- August 29th **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 5th **Financial Fragility**
Bank runs – Diamond/Dybvig Model
Defending against bank runs
 Deposit Insurance
 Suspension of Convertibility
 Lender of Last Resort
Shadow banking: Money Funds; Stable NAV and runs
- September 10th **The Money Market**
HW1, Treasury Pricing, Due
Basic Repurchase agreement: Margin, pricing and collateral
Run on Repo
Tri-Party Repo
Shorting with Repo; Securities Lending
Commercial Paper Market and Liquidity Facilities
- September 12th **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 17th **FIRST QUIZ & Options I**
Put/Call Parity
One-period Binomial Option Pricing
Multi-period Binomial Option Pricing
- September 19th **Options II and Shareholders vs. Bondholders**
HW2, Repos, Due
Fiduciary vs. Contractual duties
Enterprise vs. Equity Value
Underinvestment / Debt Overhang
- September 24th **Bond Defaults and Amendments**
Crafting Bond Contracts
Role of Bond Ratings
Events of Default: Financial vs. Technical
Role of Trustee
Consent solicitations

September 26th Guest Speaker (tentative)

October 1st **Corporate Bankruptcy**

HW3, Options, Due

Liquidating in Chapter 7

Automatic Stay

Reversal of Preferences / Fraudulent Transfers

Absolute Priority

Reorganizing in Chapter 11

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

Voting rules; exclusivity; blocking power

Section 363 auctions

October 3rd **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 8th **Municipal Finance**

Tax treatment

Muni instruments

Advance Refunding

Muni Distress & Restructuring

October 10th **Bond Prospectus Case**

Hand in Bond Prospectus Writeup

October 15th **Guest Speaker, Andrew Goldman, Wilmer Hale**

October 17th **THIRD QUIZ & Preferred Equity**

Sources of Seniority

Tax and capital-adequacy treatment

Where you see it and where you don't

October 22nd **Convertibles**

Standard Convertibles

Floating Price (Death Spiral) Convertibles

Mandatory Convertibles

Contingent Convertibles

October 24th **Consumer Credit**

Payment Cards

Mortgages; Fannie & Freddie; basic mechanics

Car loans and other installment loans

Personal bankruptcy: chapters 7 & 13

- October 29th **MBS**
Prepayment risk
Unit of prepayment risk
Sequential tranching
- October 31st **FOURTH QUIZ / ABS and other MBS strategies**
IO/PO; Floaters & Inverse Floaters; PACs & Support bonds
Managing Credit Risk
Securitizing revolving balances
- November 5th **UNDERWRITING: IPOs, SEOs and Rights Offerings**
Structure of rights offerings
SEOs: traditional / shelf offerings / bought deals
IPOs: mechanism and underpricing
- November 7th **Securitization Prospectus Case**
Hand in Securitization Prospectus Writeup
- November 12th **Mutual Funds**
Open-End Funds
Closed-End Funds
ETFs
Regulatory environment
Performance
- November 14th **FIFTH QUIZ / Market for Corporate Control**
Corporate voting
Free-rider problem with takeovers
Poison pills / Staggered boards / other defenses
- November 19th **Credit Default Swaps**
Market Structure
Valuation
Payoff calculation
Sovereign CDS
- November 26th **New security designs**
Hand in Follow-on Offerings Case
- November 28th **Guest Speaker**
- December 3rd **SIXTH QUIZ / Follow-on Offering Results**
- December 5th **Crowdfunding**
HW4, CDS, Due
- December 10th **Wrapup**
HW5 Due