

FNCE 238/738: Capital Markets
Prof. D. Musto
Course Schedule, updated 8/16/21

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), as well as a deck. All notes and other course material will be posted on the Canvas site. There is no textbook. You are advised to read the notes before class, and for the quizzes you are responsible for whatever we cover in class or in a homework or in a case. You are generally responsible for the material we discuss in class, whether or not it appears in the notes.

The assignments to be handed in, on the indicated dates, are 3 homeworks and 4 cases (3 cases for MBAs). Homeworks are to be done individually, while the cases are to be done in groups of 3 to 6.

There are five quizzes, roughly every two weeks starting 9/15. As currently scheduled the quiz dates are 9/15, 10/4, 10/27, 11/10, and 12/1. **Depending on speaker availability issues that might arise, the dates might change, but the first one will definitely be 9/15.** They will be at the start of class, taking approximately 30 minutes. In order to account for illnesses, emergencies, interviews and other events that might interfere with taking a quiz, I will count only the top 4 of your 5 scores. **There will be no makeups.** There will be no tests other than these five quizzes, and there will be no final exam.

The cases are not traditional cases in the HBS sense. One will involve analyzing a bond prospectus, the UG-only case will involve analyzing a securitization prospectus, one will cover a hostile takeover that played out locally 11 years ago, and another is an empirical study of recent SPACs.

With the new course schedule, there is 1 day that is MBA only, the first day, and there are 4 days that are UG only: 3 days between Q1 and Q2, and the Monday before Thanksgiving. The MBA-only day we will spend on largely on review and preparation, the 3 days between Q1 and Q2 we will spend on the MBS and ABS markets, and the 1 day before Thanksgiving we will spend (ONLINE) on an ABS case. We will also be online on 11/8, when we will have a guest speaker guest-hosted by Dave Erickson, with whom I teach my other class, Strategic Equity Finance (which focuses on the equity rather than debt markets).

For the final grade, the coursework will be weighted: 55% on the top 4 of the 5 quizzes, 15% on the 3 homeworks and 30% on the 4 cases (3 for MBAs). Class participation can help at the margin.

There will be 4 guest speakers; the one finalized so far is Marc Lasry. 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.

TAs: The TAs are [Stacey Chen](#), [Gordon Horowitz](#) and [Malcolm Leverett](#)

- August 30th **MBA ONLY Overview and Review**
Securities and markets we will cover
Recent trends and developments
Basics of pricing and quotation
- September 1st **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 8th **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 13th **The Money Market**
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 15th **FIRST QUIZ & Trading and Market Structure**
HW1, Treasury Pricing and Repos, Due (individual)
Insider trading and the bid/ask spread
Tactics for trading inside the spread
Retail trading pathologies
Payment for order flow
- September 20th **Options I**
Put/Call Parity
Early Exercise
Binomial Option Pricing
- September 22nd **Options II**
Multiperiod Binomial Option Pricing
Black-Scholes Formula
Delta Hedging
- September 27th **Corporate Bond Contracts**
Equity and debt as options on enterprise value
Covenants and carveouts

Events of Default and the Role of the Trustee

September 29th Guest Speaker TBA

October 4th **SECOND QUIZ & Corporate Bankruptcy**

HW2, Options, Due (individual)

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 6th **Financial Distress and Restructuring**

Free-Rider problem

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

Prepackaged Bankruptcy

Distressed-Debt Investing

October 11th **Bond Prospectus Case**

Hand in Bond Prospectus Writeup (group)

October 13th **UG ONLY Consumer Credit**

Payment Cards

Mortgages; Fannie & Freddie

Car loans and student loans

Personal bankruptcy: chapters 7 & 13

October 18th **UG ONLY MBS**

Quantifying prepayment risk

Benchmark prepayment path

Weighted-Average Life

Sequential tranching

October 20th **UG ONLY More MBS & ABS**

IO/PO; Floaters & Inverse Floaters; PACs & Support bonds

What gets securitized, what doesn't

Managing credit risk through the deal structure

October 25th **Guest Speaker: Marc Lasry of Avenue Capital (3:30 only)**

October 27th **THIRD QUIZ & Preferred Equity**

Sources of Seniority

Tax and capital-adequacy treatment

Where you see it and where you don't

- November 1st **Municipal Capital Markets**
 Tax treatment
 Muni instruments
 Muni distress, restructuring & bankruptcy
- November 3rd **UNDERWRITING: IPOs, SEOs and Rights Offerings**
 Structure of rights offerings
 SEOs: traditional / shelf offerings / bought deals
 IPOs: underwriting, SPACs & direct listings
- November 8th GUEST SPEAKER TBA w Dave Erickson
- November 10th **FOURTH QUIZ & Mutual Funds & Other Investment Conduits**
 Open-End Funds
 Closed-End Funds
 ETFs & ETNs
- November 15th **Market for Corporate Control**
 Shareholder voting and engagement
 Free-rider problem with takeovers
 Poison pills / Staggered boards / other defenses
- November 17th **Convertibles**
 Standard Convertibles
Death Spiral Convertibles
 Mandatory Convertibles
 Contingent Convertibles
- November 22nd **UG ONLY, ONLINE CLASS, Securitization Prospectus Case**
UG ONLY Hand in Securitization Prospectus Writeup (group)
- November 29th **Airgas Case**
Hand in Airgas Case Writeup (group)
- December 1st **FIFTH QUIZ / Credit Default Swaps**
 Market Structure
 Valuation and Payoff calculation
- December 6th Guest Speaker TBA
Hand in SPAC Results (group)
- December 8th **Wrapup**
HW3, CDS, Due (individual)