

FNCE 2380/7380: Capital Markets
Prof. D. Musto
Course Schedule, updated 11/11/22

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 (2 for MBAs) and 3 cases. 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 1/30. As currently scheduled the quiz dates are 1/30, 2/15, 3/22, 4/5, and 4/19. **Depending on speaker availability issues that might arise, the dates might change, but the first one will definitely be 1/30.** 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. Two involve analyzing the prospectus of a recent offering, and the other concerns the recent purchase of Twitter by Elon Musk. For each of them you can get answers from anywhere you want, as long as you cite your source.

There are 4 classes that are UG-only: the first class, 1/11, the class before Spring Break, 3/1 (when we will have an online guest speaker, so UGs and also MBAs can join from wherever they want), and the last two classes, 4/24 and 4/26. On 4/24 we will cover crypto-specific topics. I'm leaving the material for 4/19 and 4/26 largely open, for some flexibility to adapt to current events.

For the final grade, the coursework will be weighted: 55% on the top 4 of the 5 quizzes, 20% on the homeworks and 25% on the cases. Class participation can help at the margin.

There will be 3 guest speakers: Chris White from BondCliq, Marc Lasry from Avenue Capital and Mark Zandi from Moody's Analytics. A guest speaker 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 speaker dates might move. Mark Zandi will definitely be online, Marc Lasry may be online, and Chris White will be in person.

TAs: The TAs are [Angie Zhou](#) and [Tanya Kalianda](#).

- January 11th **UG ONLY: Overview and Review**
Securities and markets we will cover
Recent trends and developments
Basics of pricing and quotation
- January 18th **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
- January 23rd **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
- January 25th **The Money Market**
HW1, Treasury Pricing, Due (individual)
Basic Repurchase agreement: Margin, pricing and collateral
Run on Repo
Tri-Party Repo
Shorting with Repo; Securities Lending
Commercial Paper Market and Liquidity Facilities
- January 30th **FIRST QUIZ & Trading and Market Structure**
Insider trading and the bid/ask spread
Tactics for trading inside the spread
Retail trading pathologies
Payment for order flow
- February 1st **Options I**
Put/Call Parity
Early Exercise
Binomial Option Pricing
- February 6th **Options II**
Multiperiod Binomial Option Pricing
Black-Scholes Formula
Delta Hedging

- February 8th **Corporate Bond Contracts**
 Equity and debt as options on enterprise value
 Covenants and carveouts
 Events of Default and the Role of the Trustee
- February 13th **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
- February 15th **SECOND QUIZ & Financial Distress and Restructuring**
 Free-Rider problem
 Structuring Exchange Offers: minimum participation; exit consent; threat to file
 Prepackaged Bankruptcy
- February 20th **Bond Prospectus Case**
Hand in Bond Prospectus Case (group)
- February 22nd **Guest Speaker: Chris White from BondCliq, Both Sections**
- February 27th **Consumer Credit**
 Payment Cards
 Mortgages; Fannie & Freddie
 Car loans and student loans
 Personal bankruptcy: chapters 7 & 13
- March 1st **UG ONLY: Guest Speaker: Mark Zandi (online only, MBAs welcome)**
- SPRING BREAK**
- March 13th **Guest Speaker: Marc Lasry of Avenue Capital (3:30 only, possibly online)**
- March 15th **MBS**
 Quantifying prepayment risk
 Benchmark prepayment path
 Weighted-Average Life
 Sequential tranching
- March 20th **More MBS & ABS**
 IO/PO; Floaters & Inverse Floaters; PACs & Support bonds
 What gets securitized, what doesn't
 Managing credit risk through the deal structure

- March 22nd **THIRD QUIZ & Preferred Equity**
 Sources of Seniority
 Tax and capital-adequacy treatment
 Where you see it and where you don't
- March 27th **Municipal Capital Markets**
 Tax treatment
 Muni instruments
 Muni distress, restructuring & bankruptcy
- March 29th **UNDERWRITING: IPOs, SEOs and Rights Offerings**
 Structure of rights offerings
 SEOs: traditional / shelf offerings / bought deals
 IPOs: underwriting, SPACs & direct listings
- April 3rd **ABS Prospectus Case**
Hand in ABS Prospectus Case (group)
- April 5th **FOURTH QUIZ & Mutual Funds & Other Investment Conduits**
 Open-End Funds
 Closed-End Funds
 ETFs & ETNs
- April 10th **Market for Corporate Control**
 Shareholder voting and engagement
 Free-rider problem with takeovers
 Poison pills / Staggered boards / other defenses
- April 12th **Convertibles**
 Standard Convertibles
Death Spiral Convertibles
 Mandatory Convertibles
 Contingent Convertibles
- April 17th **Twitter Case & CDS**
Hand in Twitter Case (group)
 Market Structure
 Valuation and Payoff calculation
- April 19th **FIFTH QUIZ & TBA**
- April 24th **UG ONLY: Crypto Markets**
 Trading, Exchanges and Custody
 Lending and Collateral
 Bankruptcy
- April 26th **UG ONLY: Wrapup**
HW3, CDS, Due (individual)