

# FIN 371M - Spring 2010

## Money and Capital Markets

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Class: TTH 2:00-3:30 and 3:30-5:00 in UTC 1.104  
Office Hours: 5:00-6:00 PM, Tuesday and Thursday  
and by appointment

### Textbook

Foundations of Financial Markets and Institutions by Frank J. Fabozzi, Franco Modigliani, and Frank J. Jones, Prentice Hall (ISBN 0-13-613531-5)

### Additional Readings

Readings will also be drawn from: Investment Banking: Institutions, Politics, and Law by Alan D. Morrison and William J. Wilhelm, Jr., Oxford UP (978-0-19-954418-9), which is available as an electronic resource via the UT library. I will also probably place the hard copy on reserve.

Other readings will be made available throughout the semester. Students are encouraged but not required to subscribe to and read *The Wall Street Journal*.

The syllabus also lists a number of “readings” from economics and finance journals. Some of these will be assigned readings, while others are references for material covered in lectures. Articles marked with an asterisk are likely to contain more advanced material. Students may find the introductions to these articles to be useful supplements to notes taken during lectures.

**The readings listed on the syllabus are NOT final reading assignments, but are just a general guide. Final reading assignments will be mentioned in class and/or posted on blackboard. Assignments will be posted no later than 6:30 pm on the class day preceding the class when the reading should be completed.**

### Purpose of the Class

This class is designed to provide institutional and theoretical foundations for the wide variety of financial assets in a modern capital market. We will focus on how the needs of investors and the needs of firms interact to produce the often bewildering array of financial instruments available. A major topic in the class will be how government intervention influences the the development of such markets. We will also address why markets for money and capital seem predisposed to periods of crisis and we will address the concept of “systemic risk” within a financial system.

### Format of the Class

Classes will take the form primarily of lectures. I also anticipate assigning at least two cases, and in the case presentations students are expected to prepare reports in teams and be prepared to discuss or present their results when called upon to do so. Part of some class periods may be devoted to games, which are explained further below. My intention in lectures is to focus on presenting the economic theory that informs our understanding of the various markets, instruments and intermediaries that we study, as well as the institutional details about those markets and intermediaries. Lectures will also present current empirical work in financial economics relevant for the current topic, and I will also

endeavor to provide a rigorous presentation of select recent events in financial markets (i.e. the most recent financial crisis). Students will be expected to be familiar with institutional details at the level of the assigned readings from the textbook *before* the lecture. Certain readings not from the text will best be undertaken after the associated lecture; I will let you know when this is the case.

### Notes on the Calendar

Spring Break is from March 15 to March 20.

### Course Policies

- Students are responsible for all material in the reading and in the lectures. These will not always overlap.
- Students are responsible for finding out about any administrative announcements made during lectures that they miss.
- Use of electronic equipment (laptops, cell phones, etc.) is prohibited. Calculators may be used in class, though I doubt they will be needed.
- If you suspect an error in my grading of your exam, you must submit *in writing* your full reasoning for why the grade is in error. This must be done in a timely fashion (i.e. within 48 hours of when the class is given access to the exams).
- If at all possible, please submit any electronic documents in pdf form.
- **No student may leave any exam early, except as a result of illness. You will be permitted to (quietly) do something else after turning in the exam, but no electronic devices may be used at any time during the exam.**

### Makeups

Students missing an exam for good reason, including and more or less limited to illness or death (or extremely serious illness) in the family, may be given the opportunity to make up the exam or may instead have the remaining exams count for a higher percentage of the grade, at my discretion. Students missing an exam for a reason that I do not consider “good” (e.g. oversleeping, travel for weddings) will, at my discretion, either (1) receive a zero on the exam or (2) take the makeup exam and receive the lower of the two class grades, calculated with and without the makeup exam.

### Students with Disabilities

*The University of Texas at Austin provides upon request appropriate academic accommodations for qualified students with disabilities. For more information, contact the Office of the Dean of Students at 471-6259, 471-4641 TTY.*

## Academic Integrity

I will pursue the most severe available consequences for any act of cheating. To be more specific, I am unlikely to respond to any act of scholastic dishonesty by assigning a grade of F on the *assignment* in question. The final decision on these matters rests with the University administration.

Official University Statement: *The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the Policy Statement on Scholastic Dishonesty for the McCombs School of Business: By teaching this course, I have agreed to observe all of the faculty responsibilities described in that document. By enrolling in this class, you have agreed to observe all of the student responsibilities described in that document. If the application of that Policy Statement to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification. Policy on Scholastic Dishonesty: Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Since dishonesty harms the individual, all students, and the integrity of the University, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> or the General Information Catalog to access the official University policies and procedures on scholastic dishonesty as well as further elaboration on what constitutes scholastic dishonesty.*

## Games

Portions of several class periods may be dedicated to games, most of which are based on papers in the experimental economics literature. Games will be played with experimental currency, and I will keep track of each player's earnings. Final earnings in each class period are completely separate, and negative balances will be ignored. That is, if you perform very badly in one game, it will not ruin your chances of coming out ahead in another game and will certainly not hurt your score on an exam or anything. At the end of the class, I will convert experimental currency balances into class participation points at an exchange rate that I will determine. It is highly unlikely that anyone's grade will change as a result of performance in the games, but you will learn more and possibly have more fun if you pretend like it matters. I will NOT use any data collected for any purpose other than teaching this class, improving the experiments for future years, or, possibly, presenting the data in future classes. The data will *not* be used as part of any research project.

## Grading

Exam I:	22%
Exam II:	22%
Exam III:	21%
Case reports:	15%
Writing project:	15%
Class participation:	5%

The class will be "curved" in the sense that there is no established mapping between numerical grades on exams and final grades. I will provide sufficient statistical information about the distribution of grades on exams and other assignments that you will be able to tell where you stand. In the final assignment of grades I will endeavor to approximately match the distribution of grades standard for elective courses in finance, although I reserve the right to shift the distribution based on aggregate performance. I plan to make full use of the new +, - grading system.

## Class website

Password-protected class sites will be available for all accredited courses taught at The University. Syllabi, handouts, assignments and other resources are types of information that may be available within these sites. Site activities could include exchanging e-mail, engaging in class discussions and chats, and exchanging files. In addition, class e-mail rosters will be a component of the sites. Students who do not want their names included in these electronic class rosters must restrict their directory information in the Office of the Registrar, Main Building, Room 1. For information on restricting directory information see: <http://www.utexas.edu/student/registrar/catalogs/gi02-03/app/appc09.html>.

## Course Outline

Below is the **preliminary** outline of the course.

### Unit 1 : Money and banking

**Week 1** Overview of financial assets and financial institutions. Banking: Theory and Institutions. Chapters 1, 2, and 3.

- Bank runs, Deposit Insurance, and Liquidity. Douglas W. Diamond and Philip H. Dybvig. *The Journal of Political Economy*, 1983.\*
- The Role of Demandable Debt in Structuring Optimal Banking Arrangements. Charles Calomiris and Charles Kahn. *The American Economic Review*, 1991.\*
- Monitoring and Reputation: The Choice between Bank Loans and Directly Placed Debt. Douglas W. Diamond. *The Journal of Political Economy*, 1991.\*

**Week 2** Banking panics. Investment Banking: Theory and Institutions. Chapter 3, 13, and 14.

- Excerpt from Sherman's memoirs
- The Free Banking Era: A Reexamination. Hugh Rockoff. *Journal of Money, Credit, and Banking*, 1974.
- Morrison and Wilhelm, Chapters 2 & 3
- Optimal Financial Crises. Franklin Allen and Douglas Gale. *The Journal of Finance*, 1998.\*

**Week 3** Recent developments in the regulation of the financial sector. Theory of interest rates and the term structure. Chapters 10 and 11, except pages 196-200, and TBA.

**Week 4** Monetary policy and the market for government debt and federal funds: Chapters 4, 5, and 15.

**Week 5** Monetary policy 2: History and current events

- Introduction to *A History of the Federal Reserve, volume 1*. Allan H. Meltzer.
- Afterword to *A History of the Federal Reserve, volume 2*, reprinted in *The Road ahead for the Fed*.

### **EXAM 1: February 18th, in class**

### Unit 2 Short-term capital markets and crises

**week 6** Money market funds, commercial paper, and other short term assets. Chapters 19 and 21 (game on Th.)

**Week 7:** Bubbles, crashes, and financial crises: Theory and history

- Bubbles and Crises. Franklin Allen and Douglas Gale. *The Economic Journal*, 2000.

- Cash in the Market and Optimal Resolution of Bank Failures. Viral Acharya and Tanju Yorulmazer. *Review of Financial Studies*, 2008.\*

**Unit 3** Capital Markets

**Week 8** Equity and long-term corporate debt. Chapters 17, 18, and 20.

**Week 9** Securitization of mortgages and the GSEs: Chapters 22-24

**Case: March 25**

- Causes of the financial crisis. Viral Acharya and Matthew Richardson. *Critical Review*, 2008.

**Week 10** More on asset back securities. Derivatives and over-the-counter trading. Chapter 25-29

**Week 11** More on derivatives. Chapters 30 and 31.

**EXAM 2: April 8**

**Unit 4** : Public finance and further topics in financial regulation

**Week 12** : Regulation of non-bank financial institutions and financial markets. Financial markets and taxation. Readings TBA.

**Week 13** : Municipal bonds and auction rate securities. Chapter 16

- Dealer Intermediation and Price Behavior in the Aftermarket for New Bond Issues, Richard Green, Burton Hollifield, and Norman Schürhoff. *Journal of Financial Economics*, 2007.\*

**Week 14** : The collapse of the ARS market, the muni market, the muni insurance market, Bear Sterns, Lehman, GM (and GMAC becoming a bank), etc. etc. etc.

**Case: April 29**

**Week 15** : Stuff that has happened since January.

**EXAM 3: May 6**