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Default and Capital Structure with Equity-Linked Debts Securities

Equity-linked debt (ELD) securities are debt securities whose cash flows depend on equity prices. We have seen many examples in last twenty years that corporation makes use of its own equity as collateral to issue debts by using a special purpose vehicle (SPV). In this paper we develop a model to study the impact of those equity-linked debts on a firm's equity value and risk of default. Our model explains some of the stylized facts recorded in the recent default histories of Enron and others.