Write a summary up to 4 pages on the following article. Please address the discussion points outlined below. You are strongly welcomed to add more comments on the paper.

“Guide to PEPS – Premium Exchangeable Participating Securities,” Morgan Stanley Dean Witter, Dec. 1998.

The article addresses the pros and cons, and valuation techniques of the PEPS security. The growth of this asset class will gain momentum as long as investors continue to expect high income and significant capital appreciation from their investments and issuers continue to rationalize their operations by monetizing non-strategic assets, de-lever their balance sheets, and raise tax-advantaged capital.

1. Explain why the investors on PEPS are said to pay “performance-based conversion premium”. Also, PEPS tend to be significantly less interest rate and credit spread sensitive than convertible bonds. Why?
2. How would you make the decision to choose investing on PEPS or a convertible issued by the same company? Possibly your decision will be based on the market environment and coupons offered in the two products.
3. The article claims that the various forms of PEPS provide high income and upside participation in companies that would typically not provide such high income. Is such view too optimistic? What are the downside risks faced by the investors.
4. In Figures 8 and 9, each plot consists of 2 inclined line segments and 1 horizontal line segment. Should the 2 inclined line segments have the same slope or differing slope? Justify your argument.
5. Based on the “expiration pay-off analysis” (p.14-16), PEPS is similar to a call spread, but with a few differences. What are these differences?
6. Summarize the sensitivity of PEPS to stock volatility, skew and volatility spread, interest rates and gamma. Compare the sensitivity profiles with those of the convertible bonds.
7. Explain why the PEPS unit structure is far more tax efficient for the issuer while preserving all the other beneficial aspects of a PEPS security for investors (see p.28-30 and Figure 15).
8. Discuss the differences in tax and accounting treatments between debt PEPS and trust PEPS (see p.32-33 and Figure 17).
9. The article makes the following claims:
    - Equity PEPS allow issuers to de-leverage their balance sheets
    - Debt PEPS are a way to forward-sell common stock, and provide a way to monetize an equity stake
    - Trust structures provide a typically less expensive way to raise capital
    - Trust PEPS with stock purchase contracts allow issuers to defer earnings per share dilution

    Give your arguments to substantiate the above claims.