On the Cash-Flow and Control Rights of Contingent Capital

Abstract: Partial conversion of contingent capital (CC) provides its owners with a portfolio of equity and debt. Since the cash-flow rights on equity (debt) typically induce a preference for risk (safety), the net preference of CC-holders upon conversion will depend on their relative holdings of each asset, which in turn, depends on the amount of CC converted. Conversions also provide CC-holders with equity-control rights, which afford them greater influence over management. Taking into account these cash-flow/control rights, initial shareholders may find it optimal to: 1) select high-risk assets that create influential and risk-loving CC-holders, or 2) select low-risk assets that forestall the influence of safety-loving CC-holders.