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Title: Equity Recourse Notes: Creating Counter-cyclical Bank Capital

Abstract: We propose a new form of hybrid capital for banks, Equity Recourse Notes (ERNs),

which ameliorate booms and busts by creating counter-cyclical incentives for banks to raise capital,

and so encourage bank lending in bad times. They avoid the flaws of existing contingent convertible

bonds (cocos)--in particular, they convert more credibly--so ERNs also help solve the too-big-to-fail

problem: rather than forcing banks to increase equity, we should require the same or larger capital

increase but permit it to be in the form of either equity or ERNs--this also gives some choice to

those who claim (rightly or wrongly) that equity is more costly than debt. ERNs can be introduced

within the current regulatory system, but also provide a way to reduce the existing system’s heavy

reliance on measures of regulatory-capital.

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