Treasury officials trod tightrope for rescue deal

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As Treasury officials finalised details of the US bank recapitalisation plan over the past week, they had to strike a very fine balance.

The deal they were offering the ailing US banks had to be good enough to encourage participation and preserve the Treasury's pledge to keep it voluntary.

On the other hand, the offer could not be so sweet that it would appear damaging for taxpayers. A big obstacle was removed on Monday when, at an emergency Treasury summit, nine of the biggest US banks agreed to sign on for a combined $125bn (€92bn, £72bn) capital injection - half of the $250bn designated by the administration for direct equity purchases.

Eligibility beyond those nine will be determined after November 14, the deadline for other US banks and thrifts to apply. At a minimum, banks must be willing to take government money worth 1 per cent of their assets, weighted according to those assets' estimated risk. At the most, that figure will be 3 per cent of these risk-weighted assets - with an overall cap set at $25bn. The terms were more generous to participating banks than was the case in the UK banking rescue announced last week.

Britain is earning a 12 per cent rate on its holdings of bank equity and will prevent banks paying dividends to common shareholders until preferred shares are fully redeemed.

The US will buy preferred stock, putting it ahead of other shareholders in any pay-outs from the banks. But initially it will receive dividends of 5 per cent, moving to 9 per cent after five years.

The US Treasury will also receive warrants allowing it to buy common stock worth 15 per cent of the investment until 2018, at the bank's market price calculated as a 20-day trailing average.

Campbell Harvey, a finance professor at Duke University's business school, said this was too little. "When the warrant is so small it smacks of bail-out rather than investment," he said. The US government equity stakes could theoretically be in place indefinitely, though they may be unravelled if a participating bank can raise an equivalent amount of capital elsewhere.

Nevertheless, several restrictions were put in place, including that banks cannot increase the dividends they pay to common shareholders or engage in stock buy-backs without US Treasury approval.

In addition, chief executives, chief financial officers and the next three most highly compensated executives will be required to submit to a provision designed to stop them from taking "unnecessary and excessive risks"; a "clawback" of bonuses in the event that earnings are later proved inaccurate; a ban on "golden parachutes"; and an agreement not to deduct any compensation in excess of $500,000 from their taxes.

Although these terms are unprecedented, they are still considered relatively tame measures and will allow chief executives of some participants in the programme to keep their multimillion-dollar pay packages.