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Can Citigroup Carry Its Own Weight?

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OVER the past 80 years, the United States government has engineered not one, not two, not three, but at least four rescues of the institution now known as [Citigroup](#). In previous instances, the bank came back from the crisis and prospered.

Will Citigroup rise again from its recent near-death experience?

The answer to that question concerns not only the 276,000 employees who work at what was once the world's largest bank, but the nation's taxpayers as well. Even as Citigroup's stock has soared from a low of \$1.02 to its current \$4.09 — and the company has eked out a \$101 million profit in the third quarter along the way — it's still unclear whether it can climb out of the hole that its former leaders dug before and during the mortgage mania. If Citigroup remains stuck, taxpayers will be on the hook for outsize losses.

Citigroup remains a sprawling, complex enterprise, with 200 million customer accounts and operations in more than 100 countries. And when people talk about institutions that have grown so large and entwined in the economy that regulators have deemed them too big to be allowed to fail, Citigroup is the premier example.

As a result, the government has handed Citigroup \$45 billion under the [Troubled Asset Relief Program](#) over the last year. Through the [Federal Deposit Insurance Corporation](#), a major bank regulator, the government has also agreed to back roughly \$300 billion in soured assets that sit on Citigroup's books. Even as other troubled institutions recently curtailed their use of another F.D.I.C. program that backs new debt issued by banks, Citigroup has continued to tap the arrangement.

Citigroup is also one of only two TARP recipients so desperate for capital that they've swapped government-issued shares into common stock, diluting existing shareholders. ([GMAC](#), the troubled auto lender that may

receive another government infusion, is the other.)

While Citigroup has written down tens of billions of dollars' worth of mortgages on its books, there are looming problems in its huge credit card portfolio. Of the company's \$1.2 trillion in credit commitments outstanding in the second quarter, \$873 billion were credit card lines. A measure of the bank's efforts to wrestle that problem to the ground is the interest it charges customers: in October, Citigroup raised interest rates on some credit card holders to 29.99 percent.

Chris Whalen, editor of the Institutional Risk Analyst, calls Citigroup "the queen of the zombie dance," referring to the group of financial institutions that the government has on life support.

"They are hoping that a combination of bank assistance and maximizing revenue and buying time will let them survive," he said. "When I look at the whole picture, Citigroup is in the process of resolution. I continue to believe the equity is worth zero and that the company will have to go to bondholders for some kind of money to make the bank stable."

[VIKRAM S. PANDIT](#), Citigroup's C.E.O., said in an interview that he was confident that Citigroup was on the right course, focusing on global banking and shedding segments of the company — like insurance and the brokerage business — that aren't part of that mission. To date, he said Citigroup had sharply reduced its expenses, improved how it monitors risk, and established a management team that he said would return the bank to sustained profitability.

"Our distinctiveness is we connect the world better than anyone else," he said, noting Citigroup's global reach. "We have a great capability of building a business around that. And we are in the process of building a culture around that."

Mr. Pandit said he was working with federal regulators on a schedule for paying back TARP funds, which he said was crucial to restoring Citigroup's image among consumers. "It's very hard to change perceptions in this marketplace," he said. "We are not a troubled bank. We have a lot of assistance from the government. We can't fight that."

In trying to right itself, Citigroup plans to undo much of what it did during a period some insiders call the lost

decade — with events that included merging with Travelers Group in 1998 and a huge, dizzying expansion of its asset base. To untangle the company, Mr. Pandit has split Citigroup in half. One part consists of operations that Citigroup executives consider central to the bank's future; these include retail banking worldwide, investment banking and transaction services for institutional clients.

The other part contains businesses that Citigroup executives hope to exit or unload. This includes asset management and consumer lending, such as residential and commercial real estate, as well as [auto loans](#) and [student loans](#). Citigroup is also selling some of the many companies it acquired in recent years. In the weak economy, however, buyers are few.

To be sure, Citigroup's financial cushion has fattened significantly, thanks in large part to taxpayer relief — prompting some banking analysts to be relatively optimistic about the bank's prospects.

One is Matt O'Connor, an analyst at [Deutsche Bank](#). He says that Citigroup is still saddled with potential risks, but that it's well positioned for an economic recovery, in that it can sell off assets more quickly, or for another downturn, since it has government protection and relatively little commercial real estate exposure.

“We find Citi shares could reach \$10,” Mr. O'Connor wrote in a recent report to investors. “However this may be several years away and many uncertainties remain — both to Citi and banks over all.”

Yet compared with other big banks like [JPMorgan Chase](#) or the [Goldman Sachs](#) Group, Citigroup's operations are not yet generating enough profits to cover potentially devastating write-downs to come. In the third quarter, none of the units upon which Citigroup has pinned its hopes showed a jump in revenue.

Analysts at [Fitch Ratings](#) project that Citigroup will continue to be plagued with hefty loan loss provisions and that its operations will remain weak into 2010. The primary reason for Citigroup's woes, of course, is relatively straightforward. The bank simply placed too large a bet on risky consumer loans, especially mortgages. These were often repackaged into complex financial instruments that went sour when the economy collapsed.

Citigroup ended up eating these losses.

Citigroup also sank deeper into the swamp of troubled loans than its peers, according to interviews with more

than a dozen former employees and analysts, because of a number of other factors: a culture of deal-making that trumped efforts to help existing businesses grow on their own; constant churn among the executive ranks; the sapping of top talent; the blunting of dissent; and a drive to mimic competitors' risk-taking while failing to assess when those gambles were becoming perilous.

A byproduct of these flaws is now smoldering on taxpayers' doorstep, causing worries on Capitol Hill that the United States may never get back the bailout money it gave to Citigroup. Representative [Lloyd Doggett](#), a Texas Democrat on the House Ways and Means Committee, recently registered unease about the government's guarantee of \$300 billion in Citigroup assets and how effectively the [Treasury](#) secretary, [Timothy F. Geithner](#), was monitoring the bank.

"We cannot know the full scope of the taxpayers' potential cost from these hasty guarantees," Mr. Doggett said last week in an e-mail message. "Inexplicably, Secretary Geithner appears unwilling to commit to conduct an analysis, despite my specific request to him in March. A critical and transparent examination of the response to the [financial crisis](#) is essential not only to learn from past mistakes, but also to prevent further erosion of the public's trust in government."

The Treasury secretary declined to comment.

Neil M. Barofsky, special inspector general of TARP, has assembled a team to examine how Citigroup is using taxpayer funds. In a Sept. 21 letter to Mr. Doggett, he said: "The Citigroup guarantees raise important oversight concerns."

Those concerns are shared by others, particularly financial analysts.

"Traditional banking is still in a [recession](#), and the situation is very tenuous," said Janet Tavakoli, founder of Tavakoli Structured Finance, a consulting firm. "If we do get our money back from Citi, some of it will be the money we printed to give to them."

ALTHOUGH history does not repeat, now and then, as [Mark Twain](#) famously proclaimed, it rhymes. Nowhere in the financial world, perhaps, is that more true than for Citigroup.

During the 1920s, the institution then known as National [City Bank](#) opened stores around the country to

encourage the burgeoning middle class to invest in stocks and bonds. With little money down — 10 percent of the cost of a trade was all an investor needed to buy shares — investors poured into the stock market. Charles E. Mitchell, C.E.O. of National City, hyped these sales throughout the period. His nickname was “Sunshine Charley.”

Then came the Great Crash of 1929. Vilified as a “bankster” in the aftermath of the crash, Mr. Mitchell testified to Congress that banks “were too ready to loan, too ready to meet the competition of neighbors, too willing to cut down their margins to a point of encouraging excessive bargaining.”

Before the crash, industry practice allowed National City not only to underwrite securities but also to employ a sales army to peddle them to depositors. After Congressional hearings determined that this conflict of interest was a major cause of the debacle, lawmakers passed the [Glass-Steagall Act](#), separating activities of commercial banks (which offered plain old savings accounts and loans) from those of investment firms (which trafficked in more highflying endeavors like stock trading and underwriting).

Although thousands of smaller banks failed, government policies to prop up the banking sector helped National City and other major banks weather the Depression.

Fifty years later, what was then known as Citicorp found itself in trouble again as huge loans to developing countries in Latin America soured. The federal government weakened capital and accounting requirements to allow big American banks to survive the crisis. Still, in the early 1990s, the bank was in a precarious state because of its problems in Latin America, coupled with losses in commercial real estate and a weak economy.

Citicorp survived this crisis with an infusion of cash from a Saudi Arabian prince and a gift from [Alan Greenspan](#), then the chairman of the Federal Reserve. Mr. Greenspan’s Fed kept interest rates unusually low, allowing Citicorp and other troubled banks to borrow money cheaply and lend at higher rates to their customers.

By 1998, Citicorp had more than regained its footing and was willing to take a more aggressive stance. At the direction of its chief executive, [John S. Reed](#), Citicorp agreed to join forces with the Travelers Group, an amalgam of insurance, brokerage and investment banking services run by a brash dealmaker named [Sanford I.](#)

[Weill](#). The largest merger in history followed, creating a colossus named Citigroup with \$700 billion in assets.

Because Travelers had an investment firm under its umbrella, the creation of Citigroup prompted Congress to eliminate what remained of the Depression-era separation between Main Street banking and Wall Street trading. Mr. Reed and Mr. Weill argued persuasively for the change, and, along with the rest of the financial industry, deployed an armada of lobbyists in Washington. In 1999, Congress overturned Glass-Steagall.

“By liberating our financial companies from an antiquated regulatory structure, this legislation will unleash the creativity of our industry and insure our global competitiveness,” Mr. Weill and Mr. Reed, Citigroup’s co-chairmen and co-chief executives, said in a statement after Congress repealed the law. “As a result, all Americans — investors, savers, insureds — will be better served.”

Former employees wax nostalgic about the early days of the merger.

“Across the board, it was clearly No. 1,” said one former top executive who requested anonymity to maintain relationships with former colleagues. “You had franchises that were the envy of the world. It was a remarkably powerful institution.”

Profits soared, and by 2003, Citigroup was generating nearly \$18 billion a year in them. But even as the money flowed, the euphoria over earnings was tempered by personnel upheaval, recurrent scandals and the realities of managing such a behemoth.

Mr. Weill’s longtime sidekick and heir apparent, [Jamie Dimon](#), was ousted eight months after the merger. (He now runs JPMorgan, a bank that has weathered the financial downturn much better than most of its large rivals.) A steady exodus of top talent followed Mr. Dimon’s departure from Citigroup; it has only accelerated since the financial crisis began in 2007.

In the last decade, for instance, Citigroup has had four chief executives, six chief financial officers, seven heads of consumer banking and eight investment banking chiefs.

[Bank of America](#), by contrast, has had two C.E.O.’s, four chief financial officers and one chief operating officer during the same period — though that relative stability didn’t spare the bank from mistakes and pain in the

crisis.

After a series of financial scandals that tarnished the bank's reputation, Mr. Weill announced his retirement as chief executive at the end of 2003, handing the reins to [Charles O. Prince III](#), his longtime general counsel who had navigated the company through its various legal and regulatory crises but had never run a major financial institution. Mr. Prince did not return several phone calls seeking comment.

Deal-making largely continued unabated under Mr. Prince, while the bank's myriad parts were never effectively knit together. During his three-and-a-half-year reign, Citigroup bought five large mortgage lenders or loan servicers and four credit card lenders or portfolios. This buying spree would almost certainly have been larger had the [Federal Reserve Bank of New York](#) not barred Citigroup from making acquisitions for 12 months between the spring of 2005 and 2006 — a ban that followed complaints by foreign regulators that Citigroup's risk management practices were dangerously lax.

Even with occasional regulatory restraints, Citigroup's assets ballooned from \$1.49 trillion to \$2.19 trillion from 2005 to 2007, an increase of 46.9 percent (and three times the size of Citigroup's balance sheet when the merger that created it occurred).

But amid that impressive growth, dubious mortgage loans and questionable trading in mortgage and other debt-related securities began to undermine Citigroup's finances. One ugly class of securities continues to haunt the bank: [collateralized debt obligations](#), or C.D.O.'s.

From 2004 to the beginning of 2008, Citigroup underwrote \$70 billion in C.D.O.'s but had to keep \$57 billion of that amount on its own books when it couldn't find buyers, according to a class-action lawsuit filed in federal court in Manhattan, on behalf of disgruntled Citigroup investors. The suit contends that by late 2006, Citigroup's C.D.O. operations "had devolved into a [Ponzi scheme](#) where unsold portions of older C.D.O. securitizations were recycled as the asset base for new C.D.O. securitizations."

Furthermore, the lawsuit says, Citigroup executives engaged in various accounting gimmicks to conceal the bank's ownership of assets that eventually soured. Citigroup denies the allegations and says it will vigorously fight the suit.

Still, the unfortunate truth about the bank during the last several years, according to analysts and former insiders, is that it was managed horribly. “They just blew it,” said one former Citigroup executive, who like many others interviewed for this article requested anonymity because of pending lawsuits and a desire to preserve relationships with former colleagues. “It’s really hard to drive the car if you don’t have the headlights on.”

If Citigroup was driving blind, regulators seem to have been unaware. Officials at the Office of Comptroller of the Currency and the New York Fed — overseen at the time by Mr. Geithner, who has since become the Treasury secretary — stood by as Citigroup amassed a portfolio that would ultimately generate losses of more than \$35 billion.

CITIGROUP’S financial architecture remains rickety. One reason is that it relies much more heavily than most other large domestic banks on uninsured deposits in overseas locales, where customers are quick to pull their money at the first sign of trouble. Also, some of the accounting machinery it put in place to temporarily move assets off of its balance sheet (and make the bank look financially healthier) has backfired.

Mr. Pandit maintained that Citigroup’s strategy would take some time and depended in part on how the economy fared. Should the economy continue to improve, for instance, he said the bank would snare handsome returns when it sells off assets. Other assets, like some mortgages, for example, will simply be paid off over time, he said.

“We have time,” he said. “If markets do turn around, these are going to be very valuable businesses. This is going to take awhile.” Yet analysts say that for Citigroup to survive, it must quickly sell the businesses it wants to exit. And that is especially hard to do given that it is shopping its wares at a time when few people appear to want them, particularly Citigroup’s middle-tier operations in far-flung regions around the globe.

That means the plan to offload the orphan businesses is likely to take much longer than Citigroup’s management had hoped. In January 2009, two years was an estimate for this wind-down, but that is looking more improbable by the day, according to analysts and others familiar with the bank’s operations.

Mr. Whalen, the bank analyst, thinks that squaring away Citigroup’s problems will take more than low interest

rates and taxpayer assistance.

“Citigroup will need future capital injections,” he said. “Eventually what happens with Citigroup is the government is going to turn to the bondholders and say we can’t put any more money into this. You own the company now.”

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