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Fed Reviews Find Errors in Oversight of Citigroup

By SEWELL CHAN and ERIC DASH

WASHINGTON — Citigroup ran into trouble under the noses of federal regulators. But even after taxpayers rescued the financial giant, regulators failed to monitor the company adequately, according to reviews by the Federal Reserve.

Excerpts of two Fed reviews were released on Wednesday as the committee examining the causes of the financial crisis began three days of hearings on the problems at Citigroup, Fannie Mae and the subprime mortgage market.

The panel heard a strong defense of the Fed from its former chairman, Alan Greenspan, who fended off a barrage of questions about the Fed's failure to crack down on subprime mortgages and other abusive lending practices during his tenure.

But the excerpts, culled from thousands of documents turned over to the bipartisan Financial Crisis Inquiry Commission, painted a troubling picture of the Fed's oversight of Citigroup both before and after Mr. Greenspan left the Fed — and again after Citigroup received three taxpayer-financed bailouts.

The most recent documents from 2009 portray bank examiners from the Federal Reserve Bank of New York, then headed by Timothy F. Geithner, now the Treasury secretary, as overly optimistic about Citigroup's prospects, according to a person briefed on their contents.

They also suggest that the Fed examiners failed to move swiftly as Citigroup's financial condition deteriorated, according to this person, who spoke on the condition of anonymity so as not to jeopardize the commission's inquiry.

Together, the excerpts suggested that oversight of Citigroup was inadequate as far back as 2005 and remained so as recently as late December.

"Although the dedicated supervisory team is well-qualified and generally has sound knowledge of the organization, there have been significant weaknesses in the execution of the supervisory program," according to one excerpt of the 2009 review.

The report, characterized as a preliminary working paper, has not been approved by the Federal Reserve Board or the New York Fed. Even so, it underscores the challenges of overhauling banking supervision and regulation as Ben S. Bernanke, the current Fed chairman, has vowed to do, and comes as many in Congress are pushing to give the Fed even more responsibility for overseeing big financial companies.

William C. Dudley, who succeeded Mr. Geithner as president of the New York Fed, acknowledged Wednesday that the Fed could have done a better job.

"I think there's no question that the Federal Reserve and a lot of the other regulators could have done much better," Mr. Dudley said during a presentation at the New York Economic Club.

Mr. Geithner, who as president of the New York Fed from 2003 to 2008 was in charge of overseeing Citigroup, has not yet been interviewed by the panel's investigators but most likely will be called for questioning.

According to the Fed reviews, the New York Fed failed to keep a close enough eye on Citigroup for years. A 2005 review found that the New York Fed had neither the time nor the staffing to supervise Citigroup adequately, according to the person briefed on the review. The Fed currently has about 30 examiners assigned to Citigroup, the most among major banks. That is up from about 20 in 2006.

In his testimony Wednesday, Mr. Greenspan adamantly denied that the New York Fed had inadequate resources.

"The president of the Fed bank would have been on the phone immediately with me and complained," Mr. Greenspan said. "I find this notion of inadequacy not verifiable."

The eight-hour hearings also featured a former Citigroup mortgage lending officer, Richard Bowen III, who testified that he had alerted his bosses to "breakdowns in processes and internal controls."

From 2006 to 2007, Mr. Bowen said that decisions on poorly underwritten loans were changed from "turned down" to "approved," and that as many as 80 percent of the loans that Citigroup sold to Fannie Mae, Ginnie Mae and other investors were defective.

After several attempts to correct the problems, he sent a detailed e-mail memorandum to Robert E. Rubin, an influential Citigroup executive and board member, and several other high-ranking officers.

Under relatively friendly questioning, Mr. Bowen said that a Citi lawyer contacted him a few days after he sent the e-mail message, but did not hold an in-depth discussion with him until January 2008. He left the company after a leave of absence — a point that panel members did not ask him to publicly elaborate on.

Without specifying a timetable, a Citigroup spokeswoman said the issues raised by Mr. Bowen were promptly and carefully reviewed when he raised them and corrective actions were taken.

But much of the morning was devoted to Mr. Greenspan, who briefly testified in the dark after the lights went off. Staff members opened the curtains.

A particularly sharp exchange occurred between Mr. Greenspan and Brooksley E. Born, a panelist and former regulator who clashed with Mr. Greenspan and members of the Clinton administration over derivatives regulation — and lost that battle. In tough questioning on Wednesday, Ms. Born called on Mr. Greenspan to defend his longtime deregulatory bent.

"The Fed utterly failed to prevent the financial crisis," she said. "The Fed and the banking regulators failed to prevent the housing bubble. They failed to prevent the predatory lending scandal. They failed to prevent our biggest banks and bank holding companies from engaging in activities that would bring them to the verge of collapse without massive taxpayer bailouts."

"Didn't the Federal Reserve fail to meet its mandates, fail to meet it responsibilities?" she added.

Mr. Greenspan replied that there was a failure: an underestimation of the "state and extent" of financial risks and the ability of private counterparties to assess them.

"The notion that somehow my views on regulation were predominant and effective at influencing the Congress is something you may have perceived," he said. "But it didn't look that way from my point of view."

Sewell Chan reported from Washington and Eric Dash from New York.

A previous version of this article misstated the first name of Richard Bowen III.

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