Citigroup at brink after rush for profits

Bank's culture gets blame for allowing dangers to cascade

By Eric Dash and Julie Creswell

In September 2007, with Wall Street confronting a crisis caused by too many souring mortgages, Citigroup executives gathered in a wood-paneled library to assess their own well-being.

There, the chief executive, Charles Prince 3rd, learned for the first time that the bank owned about $43 billion in mortgage-related assets. He asked Thomas Maheras, who oversaw trading at the bank, whether everything was OK. Maheras told his boss that no big losses were looming, according to people briefed on the meeting who would speak only on the condition that they not be named.

For months, Maheras's reassurances to others at Citigroup had quieted internal concerns about the bank's vulnerabilities. But this time, a risk-management team was sent to more rigorously examine Citigroup's huge mortgage-related holdings. They were too late, however: Within several weeks Citigroup would announce billions of dollars in losses.

Normally, a big bank would never allow the word of just one executive to carry so much weight. Instead, it would have its risk managers aggressively look over any shoulder and guard against trading or lending excesses.

But many Citigroup insiders say the bank's risk managers never probed deeply enough. Because of longstanding ties that clouded their judgment, the very people charged with overseeing deal-makers eager to increase short-term earnings — and executives' multimillion-dollar bonuses — failed to rein them in, these insiders say.

Today, Citigroup, once the largest and mightiest U.S. financial institution, has been brought to its knees by more than $65 billion in losses, write-downs for troubled assets and charges to account for future losses. More than half of that amount stems from mortgage-related securities created by Maheras's team — the same products Prince fretted about in that 2007 meeting.

Citigroup's stock has fallen to its lowest price in more than a decade, closing on Friday at $3.77. At that price the company is worth just $20.5 billion, down from $244 billion two years ago. Waves of layoffs have accompanied that slide, with about 75,000 jobs already gone or set to disappear from a work force that numbered about 375,000 a year ago.

Burdened by the losses and a crisis of confidence, Citigroup's future is so uncertain that regulators in New York and Washington held a series of emergency meetings late last week to discuss ways to help the bank right itself.

And as the credit crisis appears to be entering another treacherous phase despite a $700 billion federal bailout, Citigroup's problems are emblematic of the haphazard management and rush to riches that enveloped all of Wall Street.

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All across the banking business, easy profits and a booming housing market led many prominent financiers to overlook the dangers they courted.

While much of the damage inflicted on Citigroup and the broader economy was caused by errant, high-octane trading and lax oversight, critics say, blame also reaches into the highest levels at the bank. Earlier this year, the Federal Reserve took the bank to task for poor oversight and risk controls in a report it sent to Citigroup.

The bank's downfall was years in the making and involved many in its hierarchy, particularly Prince and Robert Rubin, an influential director and senior adviser. Citigroup insiders and analysts say that Prince and Rubin played pivotal roles in the bank's current problems, by drafting and blessing a strategy that involved taking greater trading risks to expand its business and reap higher profits. Prince and Rubin both declined to comment for this article.

When he was Treasury secretary during the Clinton administration, Rubin helped loosen Depression-era banking regulations that made the creation of Citigroup possible by allowing banks to expand far beyond their traditional role as lenders and permitting them to profit from a variety of financial activities. During the same period Rubin helped beat back tighter oversight of exotic financial products, a development he had previously said he was helpless to prevent.

And since joining Citigroup in 1999 as a trusted adviser to the bank's senior executives, Rubin, who is an economic adviser on President-elect Barack Obama's transition team, has sat atop a bank that has been roiled by one financial miscue after another.

Citigroup was ensnared in murky financial dealings with the defunct energy company Enron, which drew the attention of federal investigators; it was criticized by law enforcement officials for the role one of its prominent research analysts played during the telecommunications bubble several years ago; and it found itself involved in regulatory violations in Britain and Japan.

For a time, Citigroup's megabank model paid off handsomely, as it rang up billions in earnings each quarter from credit cards, mortgages, merger advice and trading.

But when Citigroup's trading machine began churning out billions of dollars in mortgage-related securities, it courted disaster. As it built up that business, it also moved billions of dollars of the troubled assets off its books through accounting maneuvers to free capital so it could grow even larger. Because of pending accounting changes, Citigroup and other banks have been bringing those assets back in-house, raising concerns about a new round of potential losses.

To some, the misery at Citigroup is no surprise. Lynn Turner, a former chief accountant with the U.S. Securities and Exchange Commission, said the bank's balkanized culture and pell-mell management made problems inevitable.

"If you're an entity of this size," Turner said, "if you don't have controls, if you don't have the right culture and you don't have people accountable for the risks that they are taking, you're Citigroup."

Risk managers, though they carry less prestige and are paid less than Wall Street traders and bankers, can wield significant clout. Their job is to monitor trading floors and inquire about how a bank's money is being invested, so they can head off potential problems before blowups occur. Though risk managers and traders work side by side, they can have an uncomfortable coexistence because the monitors can put a brake on trading.

That is the way it works in theory. But at Citigroup, many say, it was a bit different. David Bushnell was the senior risk officer who, with help from his staff, was supposed to keep an eye on the bank's bond trading business and its multibillion-dollar portfolio of mortgage-backed securities. Those activities were part of what the bank called its fixed-income business, which Maheras supervised.

One of Maheras's trusted deputies, Randolph Barker, helped oversee the huge buildup in mortgage-related securities at Citigroup. But Bushnell, Maheras and Barker were all old friends, having climbed the bank's corporate ladder together. It was a common sight in the bank to see Bushnell waiting patiently — sometimes as long as 45 minutes — outside Barker's office so he could drive him home to Short Hills, New Jersey, where both of their families lived. The two men took occasional fly-fishing trips together. Because Bushnell had to monitor traders working for Barker's bond desk, their friendship raised eyebrows inside the company among those concerned about its controls.

> **'As long as you could grow revenues, you could keep your bonus growing.'**

After all, traders' livelihoods depended on finding new ways to make money, not all of which might be in the bank's long-term interests. But insufficient boundaries were established in the bank's fixed-income unit to limit potential conflicts of interest involving Bushnell and Barker, people inside the bank say. Bushnell and Barker did not return repeated phone calls seeking comment. Maheras declined to comment.

Traders at the New York Stock Exchange. Citigroup's stock has fallen to its lowest price in more than a decade, closing at $3.77 on Friday. Waves of layoffs have accompanied that slide, with about 75,000 jobs already gone or set to disappear from a work force that numbered about 375,000 a year ago.

Chang W. Lee/The New York Times

For some time after Sanford Weill, an architect of the merger that created Citigroup a decade ago, took control of Citigroup, he toned down the bank's bond trading. But in late 2002, Prince, who had been Weill's longtime legal counsel, was put in charge of Citigroup's corporate and investment bank.

According to a former Citigroup executive, Prince started putting pressure on Maheras and others to increase earnings in the bank's trading operations, particularly in the creation of collateralized debt obligations, or CDOs — securities that packaged mortgages and other forms of debt into bundles for resale to investors.

Because CDOs included so many forms of bundled debt, gauging their risk was particularly tricky; some parts of the bundle could be sound, while others were vulnerable to default.

It appeared to be a good time for building up Citigroup's CDO business. As the housing market around the country took flight, the CDO market, too, grew apace as more and more mortgages were pooled together into newfangled securities.

From 2003 to 2005, Citigroup more than tripled its issuing of CDOs, to more than $20 billion from $6.28 billion, and Maheras, Barker and others on the CDO team helped transform Citigroup into one of the industry's biggest players. Firms issuing the CDOs generated fees of 0.4 percent to 2.5 percent of the amount sold — meaning Citigroup made up to $500 million in fees from the business in 2005 alone.

Even as Citigroup's CDO stake was expanding, its top executives wanted more profits from that business. Yet they were not running a bank that was up to all the challenges it faced, including properly overseeing billions of dollars' worth of exotic products, according to Citigroup insiders and regulators who later criticized the bank.

When Prince took charge in 2003, he inherited a mess of warring business units and operational holes, particularly in critical areas like risk-management and controls.

"The businesses didn't communicate with each other. There were dozens of technology systems and dozens of financial ledgers," said Meredith Whitney, a banking industry analyst who was one of the company's early critics.

As the bank's CDO machine accelerated, its risk controls fell further behind, according to former Citigroup traders, and risk managers lacked clear lines of reporting. At one point, for instance, risk managers in the fixed-income division reported to both Maheras and Bushnell — setting up a potential conflict because that gave Maheras influence over employees who were supposed to keep an eye on his traders.

CDOs were complex, and even experienced managers like Maheras and Barker underestimated the risks they posed, according to people with direct knowledge of Citigroup's business. Because of that, they put blind faith in the passing grades that major credit-ratings agencies bestowed on the debt.

While the size of Citigroup's CDO position caused concern among some around the trading desk, most say they kept their concerns to themselves. "I just think senior managers got addicted to the revenues and arrogant about the risks they were running," said one person who worked in the CDO group. "As long as you could grow revenues, you could keep your bonus growing."

Prince was replaced last December by Vikram Pandit, a former money manager and investment banker whom Rubin had earlier recruited for a senior role. Since becoming chief executive, Pandit has been scrambling to put out fires and repair Citigroup's deficient risk-management systems.

Federal Reserve examiners quietly presented the bank this year with a scathing review of its risk-management practices, according to people briefed on the situation. Citigroup executives responded with a 25-page single-spaced memo outlining a sweeping overhaul of the bank's risk management.

In May, Brian Leach, Citigroup's new chief risk officer, told analysts that his bank had greatly improved oversight and installed several new risk managers. He said he wanted to ensure "that Citi takes the lessons learned from recent events and makes critical enhancements to its risk management frameworks. A change in culture is required at Citi."

Meanwhile, regulators have criticized the banking industry as a whole for relying on outsiders to help them gauge the risk of their investments.

"There is really no excuse for institutions that specialize in credit risk assessment, like large commercial banks, to rely solely on credit ratings in assessing credit risk," John Dugan, the head of the Office of the Comptroller of the Currency, the chief federal bank regulator, said in a speech this year.

Dugan noted that what caused the largest problem for some banks was that they retained dangerously big positions in certain securities — like CDOs — rather than selling them off to other investors. "What most differentiated the companies sustaining the biggest losses from the rest was their willingness to hold exceptionally large positions on their balance sheets which, in turn, led to exceptionally large losses," he said.

Dugan did not mention any specific bank by name, but Citigroup is the largest player in the CDO business of any bank the comptroller regulates.

For his part, Pandit faces the twin challenge of rebuilding investor confidence while trying to fix the company's myriad problems.

Citigroup has suffered four consecutive quarters of multibillion-dollar losses as it has written down billions of dollars of the mortgage-related assets it held on its books. But investors worry there is still more to come, and some board members have raised doubts about Pandit's leadership, according to people briefed on the situation.

Citigroup still holds $20 billion of mortgage-linked securities on its books, the bulk of which have been marked down to between 21 cents and 41 cents on the dollar. The company has billions of dollars of giant buyout and corporate loans. Citigroup also faces a potential flood of losses on auto, mortgage and credit card loans as the global economy plunges into a recession.

Also, hundreds of billions of dollars in dubious assets that Citigroup held off its balance sheet is now starting to be moved back onto its books, setting off yet another potential problem. The bank has already put more than $55 billion in assets back on its balance sheet. Citigroup now says an additional $122 billion of assets related to credit cards and possibly billions of dollars of other assets will probably return to the books.

Even though Citigroup executives insist that their bank can ride out its current difficulties, and that the repatriated assets pose no threat, investors have their doubts. Because analysts do not have a complete grip on the quality of those assets, they are warning that Citigroup may have to set aside billions of dollars to guard against losses.

In fact, some analysts say they believe that the $25 billion that the federal government invested in Citigroup this autumn may not be enough to stabilize it.

Others say the fact that such huge amounts have yet to steady the bank is a reflection of the severe damage caused by Citigroup's appetites.

"They pushed to get earnings, but in doing so, they took on more risk than they probably should have if they are going to be, in the end, a bank subject to regulatory controls," said Roy Smith, a professor at the Stern School of Business at New York University. "Safe-and-soundness has to be no less important than growth and profits, but that was subordinated by these guys."

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