

CITIGROUP REPORT

RESTRUCTURING CITI TO SERVE THE PUBLIC INTEREST

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Citigroup Report

INTRODUCTION

Citigroup is among the world's largest financial institutions. As of July 2009, it was also one-third owned by the U.S. government. Without the various subsidies and guarantees — totaling hundreds of billions of dollars — made available to Citigroup, it is very likely the bank would be insolvent. Many believe that — even with the government supports — with an honest accounting, it would be insolvent today. In the case of the failure of Citigroup, it would be taken over by the Federal Deposit Insurance Corporation (FDIC) which has a long record of “resolving” failed banks — albeit not banks of the size and reach of Citi.

The existing government stake in Citi, and the lingering prospect that the government might have to up its control share still further, raise the questions: Should the government exercise its ownership powers? And if so, how?

In the government-managed bankruptcies of General Motors and Chrysler — which has made the government the majority shareholder in GM — the Obama administration has explicitly adopted the position that it will act only as a business investor would. It has advanced this principle with regard to other ownership positions acquired in major businesses amidst the financial crisis. In this framework, the government is either a passive investor, or interested only in the return to profitability of the companies in which it holds an ownership stake.

This approach has a political appeal, as it protects the administration from claims that it is leveraging its investment intervention to advance narrow political interests. It operates from the premise that the government should sell its stake as soon as possible, and that such investment is only appropriate in emergency situations. It aims to alleviate concerns of those with an ideological opposition to government involvement in the economy.

Yet the failure to exercise an ownership stake comes with significant costs. Although the ownership power only applies to individual firms — and not to an entire industry — it is far greater than regulatory authority. The government-as-owner does not need to establish prohibitions or set boundaries on permissible activity; nor does it need to incentivize desirable activity. The government-as-owner can simply instruct its firms to do and not do certain things.

THE COLOSSUS

Present-day Citigroup is a financial colossus resulting from the passage of the 1999 Financial Services Modernization Act (known as the Gramm-Leach-Bliley Act for its lead Congressional sponsors). Prior to passage of Gramm-Leach-Bliley, the prevailing rule had been that commercial banks could not combine in one firm with insurance companies or investment banks. Pressure from big banks steadily eviscerated that rule — embodied in the Depression-era Glass-Steagall Act and subsequent updates — in the last few decades, but it remained in place until 1999. Citigroup played the central role in obtaining final repeal of Glass-Steagall, a prerequisite to government approval of the already consummated merger of Citibank and Travelers Insurance.

Ironically, Citigroup spun off Travelers Insurance in 2002, but the company remains a far-flung financial conglomerate, with operations located across the globe and ongoing commercial bank and investment banking divisions.

In its 2008 annual report, Citigroup presented itself as organized into five distinct segments.

- Citigroup's credit card segment, Global Cards, is the largest consumer business within Citi and "the world's largest provider of credit cards."
- Citi's historic core mission is consumer banking.
- Citi's "Institutional Clients Group" includes its hedge fund activities, and its securities trading, which is responsible for massive firm losses, mostly on subprime mortgages, including \$17.5 billion in 2008 alone.
- Citi's Global Wealth Management segment includes its Smith Barney brokerage subsidiary. Citi has now merged this into a joint venture with Morgan Stanley, in which Morgan Stanley holds a 51 percent majority stake.
- Citi's corporate segment serves the company's other segments.

In 2009, Citi announced that it was organizing these segments into two groups, Citicorp and Citi Holdings. In Citicorp are the credit card segment and consumer banking, along with the corporate segment. The Institutional Clients Group and Global Wealth Management are in Citi Holdings.

Citi's restructuring, says Heather Slavkin, legal and policy adviser with the AFL-CIO's Office of Investment, "appears to have been an attempt to create a good bank/bad bank structure within the Citigroup umbrella. Citicorp [in the words of CEO Vikram Pandit] is the 'global bank for businesses and consumers' (i.e., the good bank) and Citi Holdings includes businesses 'that are not central to our core operating strategy' (i.e., the bad bank)."

In 2009, Citi closed numerous branches around the country and sold off:

- Its German retail banking operations
- An Indian-based outsourcing business called Citigroup Global Services Limited

- Billing-and-collection rights on 185,000 mortgages, sold to Wilbur Ross's American Home Mortgage Servicing Unit (for \$1.5 billion);
- Its 64 percent share holding in Nikko Asset Management, to Sumitomo Trust and Banking for \$795 million, as well as Nikko Cordial Services, the third largest brokerage in Japan;
- Its majority stake in Smith Barney, merged with Morgan Stanley in a \$2.7 billion deal;
- Its consumer finance business in Sweden, Italy and Argentina;
- Its Phibro commodities-trading unit to Occidental Petroleum for \$250 million.

It has, additionally been reported to be planning sales of:

- Consumer lending in UK, Belgium, Spain and other European countries;
- Retail lending operations in Greece, Belgium, Spain and the UK;
- A Japanese call-center operation named Bellsystem24 to Bain Capital Partners for \$1.1 billion;
- Brazilian credit card company Redecard;
- Its stake in Japanese online broker Monex Group;
- Its stake in Indonesian coal producer Adaro Energy;
- Its Primerica life insurance unit;
- Its share in HDFC Bank, India's largest mortgage lender; and
- Its Italian private banking unit;

Citi's plans follow a general consensus among investment analysts that the financial behemoth is unwieldy and must be broken up.

"They're in a difficult situation," says John Jay, senior analyst with the Aite Group. "They are too big and [have] operational problems."

Sandy Weill — the former head of Travelers who became CEO of the merged Citi-Travelers entity — "was the one that put everything together," says Jay. He "wanted it to be an institution for institutions as well as for consumers. A large part of what they do is in the capital markets at the wholesale and institutional level. As that sort of unfolded, from the late 1990s to 2005, it eventually became very unwieldy."

Jay believes the financial conglomerate model can work for some firms — he points to J.P. Morgan as evidence — but says it requires the kind of superb leadership that has been absent at Citi.

Matt McCormick, vice president of Bahl & Gaynor, agrees. "It's tough enough to keep one ball in the air much less 16 or 17, which is clearly what they have on their plate right now," he says.

Emphasizing the policy importance of imposing such a divide on all firms, not just Citi, Nomi Prins, a senior fellow at the New York-based think tank Demos, and a former managing director at Goldman Sachs, says, "I think returning to a segmented banking system, à la a modern version of Glass Steagall, is the best, most sensible way to regulate the industry and protect the rest of the population from practices based on reckless, hyper-competitive behavior." Citi should be divided between its commercial banking and investment banking components, she says, and "all entities should be restricted legislatively so as to avoid the kind of off-book, over-leveraged, excessively risky practices of investment banks."

Matt McCormick, vice president of Bahl & Gaynor, agrees. "It's tough enough to keep one ball in the air much less 16 or 17, which is clearly what they have on their plate right now," he says.



Besides the problems of complexity, McCormick says, Citi's sheer need for capital will force ongoing sell-offs. "If you look at what's happening right now with Citi, there are some things they can control and some things they cannot. They can control cost cutting, they can control their lines of business," he says.

In this sense, Wall Street echoes the views of many progressive economists and advocates, who emphasize the importance of re-imposing the divide between government-insured commercial banking and the highly risky business of investment banking.

TO HOLD OR SELL OFF?

If Citi is in fact insolvent, the government basically has four options about how to proceed, says Rob Johnson, director of the Economic Policy Initiative at the Franklin and Eleanor Roosevelt Institute and formerly Managing Director at Soros Fund Management. First, it can engage in forbearance, ignoring its insolvency, providing government backing and permitting them to earn their way back into solvency over time. This is apparently the preferred alternative of the Obama administration -- but, as Johnson notes, "if the thing is so far under water that over time it can never come back to positive net worth, then it's kind of a pointless action." The second option is to take Citi over as a "bridge bank," basically

putting it under conservatorship. This is the operational manifestation of the "nationalization" option. Whether Citi would stay under government control over an extended period of time, and how it would be managed while under government control, would depend on policy choices of the kind discussed in this paper. A third option would be liquidation -- to break it up and sell off the pieces. This approach would traditionally involve maximizing returns, but it could be coupled also with efforts to advance other public objectives. These objectives could be advanced through structural approaches (for example, by facilitating the creation of new local banks through the sell-off process) or conduct rules (by attaching conditions to what the re-sold pieces of Citi must or must not do). The fourth option, says Johnson, is purchase and assumption, whereby the government would acquire Citi and quickly sell it in its entirety to another firm. This approach is not feasible in the case of Citi, notes Johnson, because of its size.

There are necessarily very complex questions involved in any such effort and the forbearance approach is in many ways the path of least resistance. The very complexity of a firm like Citi and its investments in exotic instruments poses uncertainties and complications. "The really daunting part," says Johnson, "is understanding how to restructure and reschedule all of (the bank's) derivative exposures without creating tremendous anxiety in the system."

In taking Citi into receivership or a conservatorship, however, the government would not necessarily commit itself to any course of action. William Black, a former senior deputy chief counsel with the Office of Thrift Supervision who helped expose the savings-and-loan scandal and currently teaching economics and law at the University of Missouri, says one thing is known: "We don't want Citi to continue. Or similar "too big to fail" entities to continue. We don't want banks posing systemic risk.

WHAT'S WRONG WITH CITI?

Citi is a classic example of serially abusive senior management. The recent troubles are not really unique or even terribly different. Over the past 25 years Citi has gone from crisis to crisis and bailout to bailout and abusive or even outright criminal action. If there were 3 strike laws for white collar crime, Citi would have been put out of its misery 25 years ago. ...

Our financial sector is dramatically too large. It acts as a parasite. It does not act in the way taught in finance school. It needs to be shrunk dramatically in size and no bank is critical in truth. I do agree that you could have cascading failures if you just dissolved Citi suddenly, but there's no reason it can't be broken up and sold in a controlled fashion. Nobody needs Citi.

*- William Black, former senior deputy chief counsel with the Office of Thrift **Supervision***

That's like letting people to keep storing nitroglycerine in their house." But, he says, "I don't know enough — nobody knows enough — to say how it should be broken up. ... That's why you need receivership."

One key initial question is if the government should hold on to Citigroup after nationalization, or aim to re-privatize it as fast as possible.

This is not necessarily an either-or proposition. There may be arguments for permanently maintaining some aspects of Citi in the public domain, while selling off the rest.

Professor Gerald Epstein of the University of Massachusetts, Amherst posits a range of benefits for maintaining Citi as a public bank (shorn of some components).

First, he suggests, it "can specialize in funding for 'green initiatives,' both small and large. These can include lending to business with new technology ideas; serving some of the role of venture capitalists but not requiring such a massively high rate of return and hurdle rate as they do; and smaller business loans directed at projects such as home and building refurbishing, etc. that is directed at greening the economy." A public bank could also underwrite "government bonds issued for important social goals such as green technology, education funding, mass transportation, etc. There have been massive problems reported of price fixing and other corrupt practices in the municipal and state bond markets. Having a large player in the public bond arena that can compete with and try to keep more "honest" the other players in this market would be of great use to states and locales."

Epstein notes a variety of other possible functions for a public bank. It could issue reasonably priced student loans. It could address abuses in consumer credit provision through direct service. "The government is discussing a new bill to create consumer protection in the provision of credit card and other consumer services," notes Epstein. "One way to enforce such provisions is to make the law and enforce them through monitors. Another way is to create an institution — i.e., a large public bank — that actually implements these rules and thereby imposes competitive force in the marketplace that can help force private lenders to obey by the same rules."

Finally, notes Epstein, a public bank, by providing a competitive alternative, could serve to discipline abuses by private banks. "Public banks, if they have enough market power, can help enforce standards in the financial marketplace in those areas where demanders of bank services will prefer these higher quality services. In other words, a large bank that enters the marketplace enforcing higher standards can help promote a dynamic of a 'race to the top' in the provision of high quality banking services."

Johnson, who is ambivalent about the ideal approach, notes a distinct value to a public bank: At a time when commercial banks remain reluctant to resume lending and do so to a large extent by relying on Federal Reserve backstops, he says, "If you had a government bank, you'd have the means to make it continue lending, at a time like this where there is kind of a paradox of thrift as the Keynesians call it. [Right now, there is] an inherent caution where if everybody lends then everybody's lending is safe, but if people start to pull back on lending then you don't want to be the only guy out there. It's kind of like a cooperative game among the large institutions and as long as they're all pulling back, it will imperil the macro-economy. But if you bailed out something like a Citibank and kept them in government hands, you could ensure that they continue lending and would mitigate some of the deflationary impact of everybody de-leveraging at the same time."

A different rationale for maintaining Citi under public control is that -- contrary to some of the suggestions that follow in this paper -- it cannot be subjected to effective regulation. Gar Alperovitz, author of *America Beyond Capitalism: Reclaiming Our Wealth, Our Liberty, and Our Democracy*, among many other works, argues that "at their current scale they are too big to effectively regulate. That's not an argument about what can be done in theory, it's an argument about what can be done given power politics and lobbying. In the real world they can say they are regulated, but in the real world it can't be done effectively." However, he contends, "If you break them up, they will regroup – the big fish will eat the little fish -- and you will be back to square one. So you can't break them up and you can't regulate them in practice. That leaves one option – nationalization or effective public control."

A different idea for a public bank is that it be smaller and more focused. In such a scenario, a piece of Citi would be maintained in the public arena, with the rest sold off.

States Epstein: "A second approach would be to carve out a smaller bank with one or more specialized goals. For example, the government could create the 'Green Bank of America' or 'Green Citi Bank' that would specialize in lending to private businesses and governments for green activities. Another example would be the 'Education Bank of America' and/or 'The Infrastructure Bank of America' which would focus on underwriting (possibly in public-private partnerships) the creation of more infrastructure, particularly those meeting social goals such as green transportation, etc. In this case, the government would then divide the 'good bank' into two or more parts and sell off those that would be privatized and retain those that would specialize in these actions. Of course, they would have to try to retain the depositor base in order to fund these more specialized activities."

Joel Rogers, University of Wisconsin law professor and a founder of the Apollo Alliance, emphasizes the potential value of a national bank to undertake categories of socially desirable lending that commercial banks are reluctant to do, or do at scale. "I'm working with the banks in the green technology areas now," says Rogers, "and I can tell you that the banks are extremely difficult to play with. They say, if you take this amount of risk out we can get you reasonable return, but they won't talk about the rate of return that they're willing to offer. So it would be very useful to have some bank. Of course it would have to be professionally managed and the point is

not to throw away people's money. But there are plenty of long-term investments that could be made in a variety of things that are of social use that most commercial banks are not ready and willing to help, and the bond market doesn't seem to be the right instrument for getting the right capital in. So you need something that has a security function like an investment bank, and something that has some social heart."

Alyssa Katz, a professor of journalism at New York University, editorial consultant at the Pratt Center for Community Development and author of *Our Lot: How Real Estate Came to Own Us*, echoes the general point, with regard to non-traditional home ownership schemes. She notes that a nationalized Citi could "provide capital for alternative forms of housing tenure." The heavy emphasis on individual ownership "makes buyers dependent on the vicissitudes of the marketplace," she says, in ways not compatible with long-term housing stability.

Katz says that, "There are alternatives that have been pretty thinly capitalized. One of those alternatives is shared equity housing, which takes different forms. In New York and other parts of the country there are limited equity cooperatives where you own shares in the enterprise along with many other owners. When you move out you can take what you put into it, maybe realizing some gains, but within limits. This helps to deter real estate speculation and preserve long-term affordability. These kinds of mechanisms help avoid the huge speculative bubbles that we've seen again and again, especially recently, in housing. The challenge, of course, is that when one buys shared equity interests in a basically private real estate market environment you're foregoing gains that others might realize, in exchange for security and affordability. But if the shared equity could be rolled out on a large scale and made mainstream that would make it more sustainable."



Alperovitz argues for focusing less on retail banking -- which could be maintained on a decentralized basis in the private sector -- and more on Citi's investment banking functions. "We ought to be using the bank (now that we own it) as an investment tool to do positive things under public priorities for different uses of capital. That would be a mandate – green development, public infrastructure, etc. In other words, we're talking about the big national public investment banks. ... The big investment bank should be nationalized because that's the one that requires concentrated pools of capital."

"The positive argument" for nationalizing and maintaining public control of Citi's investment bank functions, says Alperovitz, "is that you want to use it for industrial planning – investment in mass transit, rail, all the industrial policy arguments. It should paste together a bunch of functions – and show what can be done in competition with the others, including traditional investment banking – to measure the others against. And you show how it can be done without having to pay anyone more than \$200,000."

Rogers offers an important cautionary note about any schemes to maintain Citi as a public entity. "If there's some value there in Citi, fine. But that's a reasonable prior question: Whether it's even worth taking them over versus creating something new, especially if we're talking about the kinds of money that has been spent under the TARP." Unlike, say, an auto company, it is relatively easy to build up a bank. This is particularly the case for an investment bank without retail operations. So, even if one finds attractive the idea of public-controlled pools of investment capital -- and there are many potential models of how such funds might operate -- holding a piece of Citi may not be the ideal way to achieve the objective.

THE UTILITY OF CITI

A different vision for a post-takeover Citi involves re-privatizing the firm, but requiring it to operate on the model of a public utility.

The regulated utility model suggests an entity that provides a specific public service without discrimination and, according to government-specified standards, is constrained from undertaking other activities in related fields and is permitted to obtain a reasonable profit but no more.

Longtime financial regulatory expert Jane D'Arista suggests how this might be done operationally: "If Citi is declared insolvent, its deposits (for which the FDIC is already liable) should be segregated to create a new bank backed by as many good assets as needed from (or can be found in) the existing balance sheet. Capital should be provided by transferring TARP [government bailout] funds already given to Citi to the new institution."



Then, she contends, "The institution that emerges should be viewed as a utility created for the purpose of providing new loans to U.S. non-financial borrowers and primarily engaged in portfolio lending. It would, obviously, be under new management. It should be prohibited from making leveraged investments, engaging in investment banking or proprietary trading or excessive borrowing from and lending to other financial institutions. Decisions about relaxing these prohibitions should wait until regulatory reforms have been enacted."

"I like the public utility model with a variety of ownership options ranging from local private ownership, cooperative ownership or a community corporation model," says David Korten, author of *Agenda for a New Economy* and co-chair of the New Economy Working Group. We should be highlighting the variety of such possibilities. Overall, I'm inclined to make the argument that money fits within a category of services like electricity and water that are best managed as public utilities."

In addition to the kinds of prohibitions outlined by D'Arista, a utility model would imply conditions on the terms of lending that banks could undertake. A utility might well be required to adhere to rules more strict than those likely to emerge from proposals for a consumer financial regulatory agency.

CITIGROUP AT THE CITY LEVEL

There are many cross-cutting issues implicated in a government takeover and subsequent management.

For example, whether or not a re-privatized Citi is regulated as a utility, there is a question of how the post-takeover company should be broken up.

As it happens, there is a fair amount of agreement among Wall Street analysts and progressive critics on a number of points: first, the unprofitable units should be sold off or otherwise resolved; second, the firm has grown too big and unwieldy and must shrink; and third — although they come to this conclusion for different reasons — the commercial banking and investment banking operations should be split.

But many progressives believe an additional set of considerations should be taken into account in reshaping Citi. The more modest concern is addressing the too-big-to-fail problem. If, as is now prevailing wisdom, large banks and financial institutions make excessively risky investments because they know they are protected against failure by a de facto government insurance program, then

the government should take affirmative steps to shrink large banks. Where it takes over, or gains a dominant ownership stake in a too-big-to-fail bank, it should break it up into small enough pieces to escape this problem.

Suggests economist Dean Baker of the Center for Economic and Policy Research, "It was built up from regional banks. It can go back to being several regional banks."

A more aggressive perspective on breaking up Citi aims not just to address the too-big-to-fail problem, but affirmatively favors small size. In this view, the ultimate objective would be, as David Korten recommends, "Breaking Citi into the smallest viable pieces, each rooted in community by ownership and mandate."

A bias for the local, notes Stacy Mitchell, senior researcher with the Minneapolis-based Institute for Local Self-Reliance, reflects "a lot of evidence that banks are most efficient and effective at much smaller scale." Smaller banks generally are "the cheapest place to bank, and offer the best interest rates." Smaller banks are better able to tailor services to local needs, including especially the needs of small business, "because they operate at eye level" with the community. Smaller banks also have much less political power than mega-institutions, and so are less able to undermine efforts to control the financial sector."

Korten, who looks favorably on creation of community-rooted banks, nonetheless offers an important cautionary note: Small enterprises, and especially in the financial sector, can also engage in abusive practices if not subjected to appropriate public controls. He notes the corruption of the savings-and-loans, once locally rooted financial institutions with narrow purposes, and, to a lesser extent, the cases of credit unions emulating bad practices of big banks or leveraging their political power to block appropriate regulation. In a society

where "we've developed an ethic that no profit is too much and the most profit by any means is the social goal of the proper measure of market performance," any and all financial institutions must be subject to firm rules established to protect the public interest.

THE GLOBAL CITI

Citigroup has extensive global operations. It has branches and operations in 99 countries, and it lends to governments, commercial borrowers and projects all over the world. These operations span from the world's richest to poorest countries. In the Democratic Republic of Congo, for example, Citi says that "we have had a significant involvement in the DRC for many years in areas such as trade finance, treasury and corporate finance. We are taking a leading role in the financing of capital investments in the major industries of mining and manufacturing." In Bangladesh, the company says that it "now has three branches with 82 employees serving both corporate and some individual customers. Our operations encompass corporate bank, financial institutions, treasury and e-business under the global corporate and investment banking umbrella."



Although Citi takes pride in its ability to stride across the globe, its international lending and operations have imperiled the company. The firm faced insolvency as a result of the Third World debt crisis to which it had contributed so substantially, to

be rescued by loans from the International Monetary Fund to poor countries, used in turn to pay back Citi and other commercial lenders. Citi was similarly rescued from major losses in the Mexican peso crisis of 1994 and the Asian financial crisis of 1997-1998.

If the U.S. government were to obtain and maintain control of Citi, there is no apparent reason why it should maintain banking operations in other countries. This would strongly suggest the need to divest those operations. One option would be to sell them entirely, or in regional chunks, to other global banks. This might maximize revenue, but would not take into account other public interest objectives.

A different approach would aim to divest each national operation to a public, non-profit or private acquirer in the country, in keeping with the view that finance should be localized to the extent possible. "Banking should be national," insists Korten, "This is actually a fundamental premise of trade theory -- that capital should be national." Consumer advocates in developing countries caution, however, that in some cases Citi provides a degree of competition in a concentrated market. In this case, a sale or transfer to a national acquirer who is not already a market participant would spur competition, but transfer to an existing market player would conflict with pro-competition objectives. Thus it may make sense in these circumstances to consider sale to a foreign buyer, notwithstanding a presumption in favor of local acquirers.

If the U.S. government were to quickly re-privatize Citi, it could potentially avoid special consideration of the bank's international operations, and sell them in whole or part in conjunction with its overall privatization strategy. More desirable, however, would be to undertake the same kind of care that would be necessitated if the bank were to otherwise remain public, with presumptive sell-offs or transfers to local acquirers.

A separate question is how to handle Citi's commercial lending, from its U.S. center, for overseas projects. In keeping with a preference for localizing finance, David Korten of the New Economy Working Group makes a strong argument that Citi should cease further lending for overseas projects. Others, however, make a case for continued global lending, but either with a) an affirmative effort to loan for ecologically and socially beneficial projects; or at least b) a minimum requirement of respect for ecological principles, human rights and community development in all supported projects. The first approach -- emphasizing mandatory lending for ecologically and socially beneficial projects -- fits best with keeping Citi in whole or part under public control, where profit-making goals can be subordinated to other objectives. The minimum standards approach would be a fit whether a post-takeover Citi ultimately lands in the public or private sphere.

CITI AND THE ENVIRONMENT

Private financing plays a crucial role in determining the shape of the economy. Projects that can obtain financing shape our natural and social environment. Initiatives that fail to attract financing, even if they are economically viable or serve important public objectives, will stall before they get off the ground. These basic facts mean that private (and public) banking decisions have a huge impact over the fate of the planet, including most notably with respect to climate change.

Environmental objectives may appropriately be imposed on a post-takeover Citi, irrespective of the government's ongoing role or the structure of the firm post-takeover.

The overarching requirement, explains Bill Barclay of the Rainforest Action Network, should be that Citi must develop "a comprehensive climate safeguards policy approach." This policy should include the dual objectives of "a phase out of carbon intensive

financing and phase in of green lending." Barclay says that, presently, Citi's "current practice is some dabbling in 'green' lending, but no real phase out of carbon intensive financing such as new coal-fired power plants, tar sands development, etc." This disappointing record exists even though Citi is a signatory to the "carbon principles," a voluntary code which commits signatories to apply enhanced diligence for financing of fossil fuel generation financing -- emphasizing the need for mandatory rules. Rainforest Action Network has focused its attention on Citi's corporate lending, but the same standard is equally applicable to the banks' retail side.

UK NGOs have sought to impose this approach on the Royal Bank of Scotland, which, in the wake of the financial crisis, is now 70-percent controlled by the UK government. The NGOs, People & Planet, World Development Movement and Platform, argue that the UK government has adopted a formal policy to reduce greenhouse gas pollution, and to conduct climate impact assessments of any policy or project that may have climate impacts. The government has managed its stake in the Royal Bank of Scotland, which has been and remains a major supporter of oil and gas development, without regard to this overarching policy. The NGOs lawsuit alleges that failure to comply with the climate assessment objective is impermissible.¹



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<http://peopleandplanet.org/ditchdirtydevelopment/legalchallenge/legaldocuments>

This legal framework is not directly applicable to the United States (though it may have some analogs in the National Environmental Policy Act), but it establishes a useful policy framework: Where the government has a controlling ownership stake in a firm, it should make sure that firm's decisions comply with its overall climate objectives.

The organization BankTrack has established a useful framework for both mitigating bank contributions to climate change and affirmatively supporting investments in efficiency and renewables. Key mitigation measures include:

- Measuring the greenhouse gas pollution component of all financial services:
- Establishing targets to progressively diminish the amount of greenhouse gas contributing projects that are financed;
- Developing management tools for greenhouse gas mitigation.

At the end of the day, the imperative is to see a phase out of support for fossil fuel and other greenhouse gas contributing projects. Imposing this standard on a single banking firm (or the multiple firms that might emerge after a break up) would impose only a slight competitive disadvantage on the firm. It would be denied the right to finance greenhouse gas contributing projects, but while such projects may be profitable, a bank excluded from such projects would still have plenty of profitable opportunities available. It may also be the case that the apparent profitability of such projects will prove ephemeral as new climate change policies are adopted nationally and globally.

In terms of financing a transition to a carbon-free future, BankTrack urges that banks should aggressively take advantage of the nascent opportunities in renewable projects. "Just as banks may once have promoted themselves as 'Oil & Gas Bank' [Royal Bank of Scotland] and historically built

much of their business on providing capital to oil companies to exploit fossil fuel reserves, banks should now vigorously start to compete to become the bank of choice for the clean-tech, renewable energy, and energy efficiency industries." Such investments, BankTrack properly points out, offer the prospect of very healthy and increasing long-term returns: "Those banks that are first to develop a keen understanding of these industries and cultivate durable relationships with key players will enjoy significant competitive advantages as these industries mature." However, it may be difficult to force a re-privatized Citi to affirmatively favor such investments, even under a public utility model. This kind of "green bank" -- at least as a mandated outcome of a government takeover of Citi, in a context where similar obligations are not imposed on competitor banks -- would seem to fit best with a Citi (or portion of Citi) that remains in the public sector.

There are clearly a wide range of opportunities in retail banking, however, where Citi -- as a public or private entity -- could facilitate installation of efficiency and renewable energy technologies.

The new Citi could be required to include financing for retrofitting or solar panel installation, say, along with every home mortgage. The mere act of offering financing, even at market rates, could facilitate a major uptick in retrofitting and massive deployment of solar or similar decentralized technologies. Below-market rate financing, or financing paid off through savings in utility bills -- so that consumers do not need to pay any incrementally upfront cost for their investment in efficiency or renewables -- could have a dramatic effect on spurring residential (and commercial) installation of efficiency and renewable technologies.

"There are all kinds of lending strategies that might be deployed on the retail banking side," notes Michelle Chan of Friends of the Earth, "including so-called 'green mortgages' or location-efficient

mortgages. A location-efficient mortgage applies to a home that is closer to public transportation. There's a certain business logic to this. You can assume that when someone uses public transportation a lot they spend a lot less of their household income on their car, including gas, auto insurance, repairs and so forth. So they have more money to pay off their mortgage. And so therefore you can offer a slightly better deal — a couple of basis points off a loan — for a location-efficient mortgage. You could do the same thing for energy-efficient mortgages — homes that are more efficiently designed — since people will pay less for utilities."

Alyssa Katz, professor of Journalism at New York University and editorial consultant at the Pratt Center for Community Development, offers this perspective on how a government-owned Citi (or one operating under a public/private or utility model) might help remake the built landscape to advance ecological objectives: "When the federal government first got into mortgages it was pretty specific about what borrowers, i.e. developers, had to do in order to qualify for federal insurance," she says. "They had to build suburbs — single-family homes on tree-lined streets that were this wide. The government had specific mandates -- so specific that it was difficult for developers to qualify, and so they loosened the requirements over time. The only reason we have suburbs in the first place is because the federal government made its financial guarantee for mortgages contingent upon this form of urban planning. The obvious successor to that now is the inverse: Government guarantees on mortgages — either for large-scale development or for single-family purchases — need to be contingent upon real estate meeting certain standards for green building, energy efficiency and land use patterns such as density, proximity to transit and a lot of other factors."

A post-takeover Citi could help realize this vision not so much by acting on its own, but functioning as the cutting edge of a new approach to mortgage lending. "The trick to doing that is to not separate Citi from the rest of the marketplace," says Katz, "but to make it an actor in that marketplace," and then incentivize or require others to follow.

The limits on what could be done on the retail side to support efficiency and renewables -- without harming corporate profits -- are a function of imagination more than anything else. The absence of a large-scale financing operation for consumers has deterred ample consideration of the available possibilities. The government stake in Citi, and the lingering possibility of a fuller takeover, should liberate thinking in this area.

CONDUCT RULES

A separate issue from the structural issue of how a re-privatized Citi should be configured is what, if any, special rules should be imposed on re-privatized Citi. "If you put special conditions on it," notes Johnson, "then private buyers might be willing to pay less for it. That's a trade-off that people might be willing to accept for social goals, but it is a consequence."

The utility model suggests an approach to the rules that might be imposed on a re-privatized firm, but many of the kinds of restraints proposed by D'Arista could be adopted even in the absence of a full-fledged utility management scheme. One area — the only area — where the federal government has made at least some very tepid demands is in restraining executive compensation.

The financial crisis, and the practices that helped create it, along with the abusive practices for which Citi has been cited over the last decade provide a guide for a wide range of activities and practices that a post-takeover Citi should be prohibited from engaging in.

1. Citi's pay packages, like those for other top Wall Street firms, are notable for having richly rewarded poor performance by top executives and traders.

Even more important than this apparent waste of company resources, however, was the way in which out-of-control compensation packages, linked to short-term profit performance, drove Citi executives and traders to take reckless risks. For them, it was a game of heads we win, tails you lose: If they registered short-term profits, they received outrageous bonus packages; if there was longer-term fallout -- as indeed there was, that would hurt shareholders, but they would have already pocketed their bonuses.

The appropriate remedy is to cap compensation overall; and even more importantly for exemplary purposes, is to insist that bonus payments be made only according to 10-year performance, of the division in which an employee works. (Executives would be compensated according to overall firm performance.)

2. Citi, like other big banks, has engaged in a variety of practices to rip off consumers.

Citi is among the big bank perpetrators of overdraft fee abuse. Data compiled by Moebs Services, a research firm, revealed that U.S. banks expect to reap a record \$38.5 billion in customer overdraft fees this year, almost double those reported in 2000. Big banks such as Citigroup, Bank of America and Wells Fargo charge the highest fees.



Citi has engaged in a wide array of abusive practices involving credit cards. These include inappropriate marketing efforts, especially to students. Marketing to students often involves offering a reward for applying for a card. Representatives of the Student Public Interest Research Groups say it is common practice for Citi and other vendors to use on-campus tactics to induce students to sign up for a credit card – sometimes in exchange for a slice of pizza or an oversized T-shirt. PIRG also reports that the average student received five credit card solicitations in the mail per month, at least before the financial crisis hit.

Citi is gouging its credit card consumers also through annual fees, introduced after Congress in 2009 passed legislation designed to curb excessive credit card rates. The fees were previously associated only with cards that offer generous rewards programs. Citi (and other card issuers) have also been raising interest rates and fees, tweaking rewards programs, reducing credit lines and closing accounts. "We have adjusted pricing and card terms for some customers as part of our regular account reviews," said Samuel Wang, a Citigroup spokesman. "These changes also reflect the dramatically higher cost of doing business in our industry as we work to preserve the broad availability of credit. As part of this change in terms, a small number of Citi customers may be notified of an annual fee."

A re-privatized Citi should be prohibited from these specific practices, but also held to a general standard of not imposing charges and fees on consumers disproportionate to the cost to Citi of providing the service for which the fee applies.

3. Citi has engaged in very questionable accounting practices, some of which may be illegal but others of which are clearly legal.

Citi has relied heavily on off-the-books accounting, including through the use of special investment vehicles that had the effect of disguising their mortgage liability. It has also taken advantage of accounting rules enabling it to avoid marking to market the value of its mortgage-related assets, with the result that its books look considerably stronger. The use of these accounting tricks is discretionary; Goldman Sachs, for example, chooses to mark its assets to market value. A re-privatized Citi should be required to adhere to an enhanced standard for accounting, to prevent the re-privatized firm (or firms) from repeating the debacle of the financial crisis.

4. The heart of the financial crisis, and Citi's corporate crisis, are mortgage assets.

In gouging consumers, providing them with mortgages on terms less favorable than should have been available based on their credit score, pushing complicated mortgage instruments with hidden fees and adjustable interest rates, Citi (and other banks) reaped short-term profit but set itself up for the longer-term disaster in which it is now mired. The problem was made worse by its securitization of mortgage assets -- pooling of thousands of mortgages into debt instruments then sold on the secondary market. In perceiving that it did not have "skin in the game" -- a continued interest in the good performance of the loans -- Citi was more reckless than it otherwise would have been. The unfortunate irony for Citi is that it turned out to have much more skin in the game than it had thought, and the downfall of those mortgages led to the downfall of Citi.

Moving forward, a re-privatized Citi should be required to offer to consumers the best loan for which they are eligible. It should be limited only to "plain vanilla" mortgage loans -- those without tricky price-gouging features, including hidden fees and adjustable rates. This may cost it some business and some short-term gain, but it may also establish a reputation for trustworthiness that attracts business, and it should help Citi avoid getting stuck again with a mortgage portfolio of unpayable loans. Re-privatized Citi should either be prohibited from securitizing mortgages, or at least be required to maintain a very significant share (say, 25 percent) of any loan it securitizes. And, to help redress the foreclosure crisis that will persist at least until 2014, according to Goldman Sachs, Citi should be required to offer any person or family living in a foreclosed house the right to maintain residence as a renter paying a fair market rent. This approach will help preserve home values, avoid needless displacement of families and disruption of communities, and also encourage Citi to renegotiate loan terms, involving not just reductions in monthly payments, but reduction in underlying principal to reflect market values.



5. The proliferation of exotic financial instruments led to massive leveraging and complicated interconnections among top firms that no one could track.

While financial derivatives are rationalized as helping economic players hedge against risk, it turns out they are primarily speculative tools used overwhelmingly by a small number of players. This concentration of massive speculative betting continues, with five banks -- including Citi -- owning more than four-fifths of the notional value of all outstanding derivatives in the United States. The notional value of these banks' derivatives exceeded \$190 trillion in the first quarter of 2009.

A re-privatized Citi should be prohibited from investing in derivatives. An exception to this prohibition may possibly be justified in the case of investment banking operations spun off from, an independent of, Citi's commercial banking operations. But given the ability of even non-banks to threaten the financial system, it is not clear that any exception is appropriate.

For now, it appears that Citi is moving in the exactly opposite direction. Business Week reported in August that instead of swearing off risky financial products, big banks including Citigroup have rolled out a variety of "newfangled corporate credit lines tied to complicated and volatile derivatives," linking the credit lines "both to short-term rates and credit default swaps (CDSs), the volatile and complicated derivatives that are supposed to act as 'insurance' by paying off the owners if a company defaults on its debt."



6. In December 2008 the Government Accounting Office reported that Citigroup had 427 subsidiaries in jurisdictions listed as tax havens or financial privacy jurisdictions (including 90 in the Cayman Islands alone) -- the largest number of any Fortune 100 company.

Offshore bank accounts are used to facilitate tax evasion, engage in illicit activity (including money laundering), and even hide the banks' own "toxic assets," making it difficult for regulators to accurately measure the bank's balance sheet.

That Citi might be using extremely complex financial arrangements to hide its true financial situation should come as no surprise, given the bank's role in helping Enron and other companies hide their true financial situation. According to one Senate investigation, big banks including Citi were pivotal players -- the architects of the offshore special purpose entities used by Enron's CFO Andrew Fastow to hide the company's debt. In addition, Citigroup (and Chase) "developed the deceptive pre-pays as a financial product and sold it to other companies as so-called balance sheet-friendly financing, earning millions in fees for themselves in the process."

Turning its attention to the bank's role in individual offshore account abuses, investigators from the Senate Permanent Subcommittee on Investigations learned years later "that Citibank Private Bank routinely offered to its clients private banking services which included establishing one or more offshore shell corporations -- which it called Private Investment Corporations or PICs -- in jurisdictions like the Cayman Islands. The paperwork to form the PIC was typically completed by a Citibank affiliate located in the jurisdiction, such as Cititrust, which is a Cayman trust company. Cititrust could then help the PIC open offshore accounts, while Citibank could help the PIC open U.S. accounts."

To prevent this kind of activity from occurring, all Citi subsidiaries and Citi-managed bank accounts (including client bank and credit card accounts) in the 34 or so offshore secrecy jurisdictions identified by Congress or the IRS should be immediately closed. Citi should agree to be liable if it is found to be facilitating improper tax avoidance by helping clients establish offshore accounts.

The story of the financial crisis can be told like this: powerful Wall Street interests leveraged their political power to win deregulatory rules that let them become bigger and more profitable (at least in the short term).

As they grew still bigger, they gained more political power, enabling them to push for more deregulation. When the financial crash came, they were perceived to be too-big-to-fail, too-interconnected-to-fail, and too-opaque-to-fail (after all, no one could be sure of the consequences).

If this version of the financial crisis has merit, then the strongest supporting evidence comes from Citigroup, which -- along with Goldman Sachs -- has leveraged its influences and used its close association with political power to gain special regulatory and subsidy gifts.

Robert Rubin (who the New York Times once described as the "architect of the bank's strategy" until recent years) is a poster child of what's wrong with the revolving door between government and industry. Rubin helped push Congress to pass the legislation that would repeal decades-old restrictions on the formation of commercial and investment banking conglomerates. Rubin helped broker the final compromise on the 1999 Gramm-Leach-Bliley legislation just days before joining the company as vice president.

But Rubin is just one example of the many ties that Citi has to its own overseers. On April 27, 2009, the New York Times reported that current Treasury Secretary Timothy Geithner "was particularly close to

executives of Citigroup, the largest bank under his supervision. Robert E. Rubin, a senior Citi executive and a former Treasury secretary, was Mr. Geithner's mentor from his years in the Clinton administration, and the two kept in close touch in New York. ... But for all his ties to Citi, (while serving at the New York Federal Reserve) Mr. Geithner repeatedly missed or overlooked signs that the bank — along with the rest of the financial system — was falling apart. When he did spot trouble, analysts say, his responses were too measured, or too late."

When Geithner arrived at the NY Fed, Citi's then-CEO Sanford Weill was a member of the NY Fed's board. "Mr. Geithner met frequently with Sanford I. Weill, one of Citi's largest individual shareholders and its former chairman, serving on the board of a charity [National Academy Foundation], Mr. Weill led. As the bank was entering a financial tailspin, Mr. Weill approached Mr. Geithner about taking over as Citi's chief executive."

"Throughout the spring and summer of 2007, Geithner met repeatedly with members of Citigroup's management, records show...From mid-May to mid-June alone, he met over breakfast with Charles O. Prince, the company's chief executive at the time, traveled to Citigroup headquarters in Midtown Manhattan to meet with Lewis Kaden, the company's vice chairman, and had coffee with Thomas G. Maheras, who ran some of the bank's biggest trading operations."

According to the Times, Weill even offered Geithner the chance to succeed him as CEO after he left, but Geithner turned the offer down.

Other ties that Citi has to the Obama administration include:

- Richard D. Parsons, the new chair of Citigroup (as of 1/09), was a member of Obama's transition economic advisory board.

- Deputy Secretary of State Jacob Lew, is the former CFO for Citi's Alternative Investments Group.
- Michael Froman, Obama's Deputy National Security Advisor for International Economic Affairs also worked in Citi's Alternative Investment Group. Froman was chief of staff to former Treasury Secretary Robert Rubin during the Clinton administration, and followed him to Citi.
- David Lipton, Froman's deputy, is Citi's former head of global country risk management.
- Lewis Alexander, Counselor to Treasury Secretary Tim Geithner, is a former Citi Chief Economist.



Citi's political influence is not only due to its personal associations. Citi invested hugely in campaign contributions and lobbying over the past decade (1998-2008), spending almost \$20 million on contributions and more than \$88 million on lobbying. The firm has even spent \$3 million in 2009, the period when the very federal government it is lobbying has kept it on life support.

Post-takeover Citi should stay out of the political arena. It should make no campaign contributions and no expenditures on lobbying. It should be bound to a five-year revolving door rule, so that it is prohibited from hiring regulators until at least five years after they leave their regulatory position.

There is also the question of what, if any, affirmative requirements should be imposed on re-privatized Citi. No one advocates requiring the re-privatized Citi to make bad loans, but it is also clear that some affirmative duties can encourage or require profitable lending that would otherwise not take place. The Community Reinvestment Act, which encourages banks to make more loans to low- and middle-income communities and borrowers, is an example of how affirmative duties can be imposed on banks. Versions of some of the ideas for the functions a nationalized Citi might perform may also be applicable in this context.

CONCLUSION:

WASHINGTON ON AUTO PILOT

In Washington, what is notable is not the lack of agreement on how the government should shape Citi, but the assumption that this question should be off the table — notwithstanding the hundreds of billions of dollars in public supports provided to Citi. Our position is to reject this assumption all together. We believe the question must be asked. Even though there are no simple, obvious, clear-cut answers, but they should be the subject of robust democratic debate.

Appendix:

List of people interviewed

Gar Alperovitz is a professor of political economy at the University of Maryland, College Park, and director of the Democracy Collaborative (see www.community-wealth.org). He is the author of numerous books, including *America Beyond Capitalism* (New York: John Wiley & Sons, 2006).

Dean Baker is an economist and co-director of the Center for Economic and Policy Research (www.cepr.net) in Washington, DC. He is the author of numerous articles and books, including *Plunder and Blunder* (PoliPoint Press, 2009).

Bill Barclay is a senior campaigner with Rainforest Action Network's (www.ran.org) Global Finance Campaign (San Francisco, CA).

William K. Black is an associate professor of economics and law at the University of Missouri – Kansas City (UMKC), and former litigation director of the Federal Home Loan Bank Board, deputy director of the FSLIC, SVP and General Counsel of the Federal Home Loan Bank of San Francisco, and Senior Deputy Chief Counsel, Office of Thrift Supervision. He is also the author of *The Best Way to Rob a Bank is to Own One* (Austin, TX: University of Texas Press 2005)

Michelle Chan is the Green Investments Program Director for Friends of the Earth (San Francisco, CA).

Jane D'Arista is a research associate at the Political Economy Research Institute at the U. of Massachusetts, Amherst (www.peri.umass.edu) and programs director for the Financial Markets Center. She is the author of the influential study of U.S. financial regulation, *The Evolution of U.S. Finance* (M E Sharpe, 1994).

Gerald Epstein is a professor of economics at the University of Massachusetts, Amherst and co-director of the Political Economy Research Institute (www.peri.umass.edu). He is the author of numerous books and publications, including *Financialization and the World Economy* (Edward Elgar Press 2004)

Michael Hudson is president of the Institute for the Study of Long-Term Economic Trends (ISLET), and professor of economics at the University of Missouri-Kansas City. Dr. Hudson is a former Wall Street analyst and the author of numerous books, including *Global Fracture: The New International Money Order* (Pluto, 2005).

John Jay is a senior analyst with the Aite Group.

Rob Johnson is director of the Economic Policy Initiative at the Franklin and Eleanor Roosevelt Institute, a member of the UN Commission of Experts on Finance and International Monetary Reform, and a former Chief Economist of the US Senate Banking Committee.

Alyssa Katz is a professor of journalism at New York University and editorial consultant at the Pratt Center for Community Development. She is the author of *Our Lot: How Real Estate Came to Own Us* (NY: Bloomsbury, 2009).

Helen Kearney is the associate editor of OnWall Street.com.

David Korten is co-chair of the New Economy Working Group and the author of numerous books, including *Agenda for a New Economy* (San Francisco: Berrett-Koehler, 2009). See www.davidkorten.org.

Matt McCormick is a portfolio manager and banking industry analyst with Bahl & Gaynor Investment Counselor Inc. in Cincinnati, which specializes in dividend stocks.

Stacy Mitchell is a senior research with the Institute for Local Self-Reliance's New Rules Project (www.newrules.org). She is an expert on land use and community development policies and the author of *Big-Box Swindle* (Boston: Beacon Press, 2006).

Robert Monks is a leader in shareholder activism and founder of Lens Governance Advisors, as well as Institutional Shareholder Services, Inc. He is the author of numerous books on corporate governance and accountability, including *Corporocracy* (New York: John Wiley & Sons, 2007). See www.ragm.com.

Robert Pollin is a professor of economics and founding co-director of the Political Economy Research Institute (PERI) at the University of Massachusetts, Amherst (www.peri.umass.edu). His books include *A Measure of Fairness: The Economics of Living Wages and Minimum Wages in the United States* (co-authored, 2008) and *Contours of Descent: U.S. Economic Fractures and the Landscape of Global Austerity* (Verso: 2005).

Nomi Prins is a journalist and senior fellow at the New York-based think tank Demos. She is a former managing director at Goldman Sachs, and previously ran the international analytics group at Bear Stearns in London. She is the author of numerous books, including (most recently) *It Takes a Pillage*. See www.nomiprins.org.

Joel Rogers is a professor of law, political science, and sociology at the U. of Wisconsin and director of both the Center on Wisconsin Strategy (www.cows.org) and the Center for State Innovation. He is a founder of the Apollo Alliance (www.apolloalliance.org – a coalition of labor, business, environmental, and community leaders working to catalyze a clean energy economy, and co-author (with Richard Freeman) of *What Workers Want* (Russell Sage Foundation, 2006).

Heather L. Slavkin is a senior legal and policy advisor with the AFL-CIO's Office of Investment.

Rick Wolff has taught economics at University of Massachusetts at Amherst since 1981. His numerous books and articles include *Re/Presenting Class: Essays in Postmodern Political Economy* (co-editor; Duke U. Press, 2001).