Citigroup ousts CEO, warns of billions more in subprime losses

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Citigroup Inc., the biggest US bank, on Sunday announced the resignation of its chairman and chief executive officer, Charles Prince, and warned that it might be forced to write off an additional $11 billion in losses in mortgage-linked securities.

The developments at Citigroup underscore the depth and breadth of the crisis that is gripping major financial institutions both in the US and internationally. Far from the credit crisis that erupted last summer having been resolved by two successive cuts in US interest rates and other measures to pump liquidity into the markets, the implosion of the real estate boom and related credit bubble is only beginning to take its toll on the American and global financial system.

The ouster of Prince came less than a week after the forced resignation of Merrill Lynch Chairman and CEO E. Stanley O'Neal. The Merrill Lynch chief was pushed out after the company revised upward its mortgage-related losses in the third quarter from $5 billion to $8.4 billion and announced a net quarterly loss of $2.3 billion.

O'Neal left with a $161.5 million retirement package, on top of his $48 million paycheck for 2006.

In mid-October, Citigroup wrote off $6.5 billion in devalued assets linked to subprime mortgages and other high-risk investments and announced a 57 percent decline in profits. Last Thursday, several analysts downgraded its stock and one warned that the bank would be forced either to slash its stock dividend and or sell off assets to make up for a $30 billion shortfall in capital.

That sent Citigroup stock plunging and sparked a panicky sell-off centered in financial stocks, resulting in a fall in the Dow Jones Industrial Average for the day of 362 points. Citigroup stock fell 6.9 percent Thursday and another 2.6 percent on Friday. The bank's stock is down by more than a third since the beginning of the year.

Citigroup's board of directors called an emergency meeting over the weekend and Prince, who headed the company since 2003, offered his resignation. Prince will reportedly walk away with an estimated $99 million in vested stock holdings and a pension, on top of the $53 million in salary and bonuses he received over the last four years.

Last April, Prince unveiled a cost-cutting plan that slashed 17,000 jobs, or 5 percent, of the bank's worldwide staff of 327,000. A lawyer and close confidant of the previous CEO, Sanford Weill, Prince was chosen by Weill to take the bank's top post when Weill retired in 2003. Prince was preoccupied in the first period of his tenure with legal suits and investigations arising from Citigroup's role in the financial and accounting fraud that accompanied the collapse of Enron and WorldCom.

On Sunday, the bank's directors chose Robert E. Rubin to assume the post of chairman and picked Win Bischoff as interim chief executive. Bischoff heads Citigroup's European operations. Rubin was co-chairman of the investment banking giant Goldman Sachs before joining the Clinton administration, where he served as treasury secretary from 1995 to 1999. After leaving government, he joined the board at Citigroup, becoming head of the bank's executive committee.

The shakeup at Citigroup and announcement of further massive losses from the collapse of the US housing and mortgage markets rattled stock exchanges around the world, resulting in declines Monday across Europe and Asia. The Dow Jones average fell 51 points, with Citigroup stock declining another 4.9 percent.

The crisis at Citigroup exemplifies the potentially catastrophic fallout from the collapse of highly speculative and intrinsically unstable financial manipulations that fueled the real estate and stock market booms of the past several years. Banks, investment banks, brokerages and other financial institutions both in the US and internationally, seeking quick and extremely high returns on their investments, increasingly traded in so-called “collateralized debt obligations,” or CDOs.

High-risk, high-interest loans, such as subprime mortgages to home buyers with weak credit, were pooled, divided up and repackaged as CDOs and sold to other financial institutions and big investors. The “securitized” debt instruments, ultimately underpinned by shaky mortgages, were given triple-A credit ratings by rating services such as Moody’s, Standard & Poor’s and Fitch, and traded as though they were highly secure bonds. The credit agencies contributed to the explosion of paper values in part because they are paid by the same financial institutions whose securities they rate.

As long as the housing market continued to soar, and home prices continued to rise, the credit bubble could be sustained. But once the housing market slumped, and subprime mortgages began to default, confidence in the value of CDOs and similar debt instruments rapidly eroded.

The bottom began to fall out last summer, when two Bear Stearns hedge funds, heavily invested in subprime mortgage-linked securities, collapsed. Suddenly, there were virtually no buyers for CDOs, and credit markets froze.

Banks on Wall Street as well as in Europe were stuck holding tens of billions of dollars in CDOs whose real value could not be accurately determined, but which could be only a fraction of their previous market price.

Citigroup had aggressively plunged into the CDO market, underwriting $34 billion worth in 2006, making it the second largest backer of CDOs, after Merrill Lynch. On Sunday, Citigroup reported that it was holding $55 billion in subprime-related assets.

In October, the credit rating agencies slashed their ratings on tens of billions of dollars of CDOs, forcing the banks to write down their CDO holdings. It is estimated that banks worldwide have to date written off $30 billion in CDO losses.

Citigroup is also dangerously exposed to the meltdown of another form of high-risk financial manipulation, known as structured investment vehicles, or SIVs. Citigroup pioneered in the development of these multibillion-dollar investment funds in the 1980s, and is today, of all the major banks, most heavily involved in them.

Citigroup has established seven SIVs with assets valued at $80 billion. These are off-balance-sheet companies set up by banks, but nominally independent, much like the off-the-books entities set up by Enron to conceal its riskiest financial gambles.

The SIVs made huge profits by issuing short-term debt known as commercial paper and using the cash to invest in high-risk, high-yield longer-term securities such as those based on subprime mortgages. They made money from the difference, or spread, between the relatively low interest they paid on their commercial paper—rated a safe investment by credit agencies—and the interest they earned on their speculative securities.

Since they are not subject to the same regulations that apply to their parent banks, the SIVs are not required to maintain the same level of capital reserves. They often issue commercial paper for 90 percent or more of the value of their assets. Their profits depend on their ability to continually issue new commercial paper to mutual fund money markets and other big investors to cover their past debts, while they benefit from entirely speculative financial manipulations.

The parent banks of SIVs generate huge profits by charging fees to their “independent” offspring.

The collapse of the housing and mortgage markets, and resulting contraction in credit, have made it impossible for the SIVs to sell their commercial paper to increasingly skeptical investors, while the underlying value of their assets has been thrown into question.

Last month, the US Treasury Department, with the blessing of the Federal Reserve Board, brokered a scheme to raise $80-$100 billion to prevent the collapse of the SIVs—a plan devised in the first instance to forestall a potentially disastrous crisis at Citigroup. There are growing indications that the scheme may fail.