US government brokers Citigroup takeover of Wachovia Bank

Barry Grey
30 September 2008

The restructuring of the US financial system, concentrating financial resources and power in the hands of a few banking behemoths, took a further step Monday with the sale of the banking operations of Wachovia to Citigroup, the nation's largest bank.

The demise of Charlotte, North Carolina-based Wachovia, the fourth largest US bank, came only four days after the biggest bank failure in American history, the collapse of Washington Mutual. The banking operations and deposits of Seattle-based WaMu, the largest savings and loan and sixth biggest bank in the US, were immediately sold off to JPMorgan Chase, in a deal brokered by the Federal Deposit Insurance Corporation (FDIC), the federal agency that insures deposits at commercial banks.

Treasury Secretary Henry Paulson and Federal Reserve Board Chairman Ben Bernanke were both involved in an intensive effort over the weekend to find a buyer for Wachovia. President Bush was also consulted, according to press reports.

Wachovia is the first major US commercial bank to fall in the widening credit and banking crisis.

The FDIC announced early Monday that Citigroup would acquire Wachovia, which was teetering on the edge of collapse, at the fire-sale price of $1 a share, or about $2.2 billion. Citigroup demanded that the government assume some of Wachovia's losses as a condition for its purchase of the firm's banking operations, assets and liabilities.

Citigroup will absorb more than $42 billion of losses on Wachovia's $312 billion pool of loans, the FDIC said in a statement. The regulator said it would take on losses beyond that amount in exchange for $12 billion in preferred stock and warrants.

This obligation could further erode the FDIC's deposit insurance fund, which is used to guarantee customers' deposits in commercial banks up to $100,000. The collapse of IndyMac last July drained $8.9 billion from the $45.2 billion fund, leaving it dangerously depleted under conditions of a growing banking crisis that threatens to claims dozens more institutions, big and small.

Citigroup will acquire Wachovia's $400 billion in deposits as well as its network of some 3,300 branches and offices in 21 states.

Wachovia had invested heavily in high-risk adjustable rate mortgages, which have defaulted at an ever-rising rate since the implosion of the housing and credit bubbles last year. The bank holds about $122 billion of adjustable-rate home loans, making it the largest holder of such assets, ahead of the now-bankrupt Washington Mutual. Analysts at Fitch Ratings predict default rates on such loans packaged as securities may reach 45 percent.

The bank also faced losses on loans made to homebuilders and commercial real estate developers. Wachovia reported $9.7 billion of losses in the first half of 2008.

In June, the board ousted G. Kennedy Thompson, the bank's longtime chief executive. He was succeeded in July by Robert K. Steel, a former top lieutenant of Treasury Secretary Henry Paulson at Goldman Sachs and then the Treasury Department.

Following the failure of Lehman Brothers two weeks ago, Wachovia customers began withdrawing their deposits in large numbers and the bank's stock plummeted. It shares, which finished last week at $10 on the New York Stock Exchange, traded for 95 cents at 9 a.m. in early transactions on Monday. It sold for more than $48 in February 2007.

Following the purchase of Merrill Lynch two weeks ago by Bank of America, the rash of failures and buyouts of major US institutions has left fully one-third of all US bank deposits in the hands of three monoliths—Citigroup, Bank of America and JPMorgan Chase. These financial companies now control a vast network of branches and trillions of dollars in assets, putting them in a position to set fees and interest payments on everything from commercial loans to credit cards and home mortgages.

The further monopolization of the financial system will increase pressure on small and midsize banks, undermining their competitive position and forcing many of them to close or sell out to bigger rivals.

Since last March, the investment bank Bear Stearns has been sold off to JPMorgan Chase, in a rescue operation that included a $29 billion subsidy to JPMorgan by the Federal Reserve; IndyMac Bankcorp., a large California savings and loan, has failed; Lehman Brothers, another Wall Street titan, has filed for bankruptcy; and the government has taken over the mortgage giants Fannie Mae and Freddie Mac and the insurance conglomerate American International Group (AIG).

Even without the Bush administration's proposed $700 billion-plus bailout of Wall Street, the US Treasury and the Federal Reserve have pumped hundreds of billions of dollars into the financial industry, in low-cost loans and taxpayer-financed subsidies, in an attempt to contain the greatest financial crisis since the Great Depression. At the same time, the government has used the crisis to engineer a vast consolidation of the banking system.

The takeover of Wachovia by Citigroup will likely result in major job cuts, adding to the more than 150,000 jobs that have already been slashed at US banks and financial institutions since the onset of the credit crisis in August of 2007.

G. Kennedy Thompson, the CEO who was ousted last June, received a severance package of $1.45 million and accelerated vesting of $7.25 million in restricted stock.