

US bails out Citigroup and prepares to give trillions more to banks

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The government bailout of Citigroup marks a new stage in the utilization of the public treasury to rescue Wall Street banks and finance houses. The deal reached shortly before midnight Sunday places an estimated \$249 billion in taxpayer money at the disposal of Citigroup and the bank's major shareholders, lenders and executives.

It marks the single biggest government bailout to date, outstripping the \$200 billion allocated in the takeover of mortgage finance giants Fannie Mae and Freddie Mac and the more than \$150 billion given to insurance conglomerate American International Group.

The agreement reached between the failing bank and top federal regulators, headed by Treasury Secretary Henry Paulson, Federal Reserve Chairman Ben Bernanke and New York Federal Reserve Bank President Timothy Geithner, makes the government responsible for the vast bulk of a \$306 billion pool of worthless or dubious residential and commercial loans and mortgage-backed assets, in addition to injecting \$27 billion in government funds into Citigroup's coffers in return for preferred shares of stock.

The terms of the deal are extraordinarily favorable to the bank, which is allowed to pay lower-than-market interest on the preferred shares without having to accept any government control over its investment or lending policies.

The current management, headed by CEO Vakrim Pandit, will remain in place. There are no requirements that the bank use the federal money to lend to other banks, businesses or consumers, restrictions on executive compensation are of the same token character as those included in the original \$700 billion bank bailout package approved last month by Congress, and a requirement that the bank adjust the mortgage terms for some distressed homeowners mirrors a program already instituted by Citigroup.

The three agencies that brokered the deal, the Treasury Department, the Fed and the Federal Deposit Insurance Corporation (FDIC), let it be known that the Citigroup bailout would set the pattern for similar rescue operations of other banks and financial institutions. President George W. Bush underscored this point in remarks to the press Monday morning following a meeting with Paulson and other top economic advisers.

"We have made these kinds of decisions in the past, made one last night, and if need be we're going to make these kind of decisions to safeguard our financial system in the future," Bush said.

He pointedly announced that he had informed President-Elect Barack Obama of the bailout agreement on Sunday. Obama, for his part, went out of his way to make it clear that the Wall Street bailout would continue

when he takes office in January, telling the press that he was committed to do "whatever it takes" to shore up the financial system and announcing that he had spoken on Sunday with Bush and Fed Chairman Bernanke. Standing behind Obama at a press conference called to announce his top economic advisers was Geithner, his pick for treasury secretary, who had spent the previous two days working out the terms of the government rescue of Citigroup.

According to a report posted Monday by *Bloomberg News*, with the rescue of Citigroup the US government has to date provided \$3.18 trillion to financial institutions in the form of loans, cash infusions and federal guarantees of assets.

Under conditions of a deepening US and world recession that is further undermining the financial markets, this represents only a down-payment on the vast social resources and taxpayer funds that will be channeled into securing the economic interests and personal fortunes of the American financial elite. As Kenneth S. Rogoff, a professor of economics at Harvard put it, "It will mean spending trillions of dollars."

The United States is, quite literally, being bankrupted to rescue the Wall Street multi-millionaires whose reckless pursuit of bloated profits and compensation packages precipitated a breakdown of the global financial system that is threatening to plunge the world into a new Depression.

Under the terms of the bailout, as reported in the press, the Treasury Department, the FDIC and the Federal Reserve will guarantee all but \$40 billion of a pool of \$306 billion of the \$2.2 trillion in assets on Citigroup's books, including residential mortgages, commercial real estate, leveraged loans, collateralized debt obligations and auction rate securities.

Citi will absorb the first \$29 billion in losses from the government-backed asset pool, use \$7 billion in reserve capital to cover additional losses and pay 10 percent of any further losses. The Treasury will take on the next \$5 billion in losses after the \$36 billion covered by Citigroup, the FDIC will absorb the following \$10 billion in losses, and the Fed will cover the rest.

The Treasury Department will also inject \$20 billion from the \$700 billion Troubled Assets Relief Program (TARP) into Citi in return for preferred stock, for which the bank will pay an annual dividend of 8 percent. Citigroup will receive an additional \$7 billion in return for preferred shares issued to both the Treasury and the FDIC as recompense for their roles in guaranteeing the bank's failing assets.

In addition to this \$27 billion capital infusion, according to the *Financial Times*, the "reconstruction of Citi's balance sheet in effect frees

up an additional \$13 billion, so the total capital benefit to Citi will be \$40 billion.”

This cash infusion is over and above the \$25 billion handed to Citi by the Treasury last month as part of \$125 billion allocated to the nine biggest US banks.

Citi will also issue warrants to the US Treasury and the FDIC for some 254 million common shares at a strike price of \$10.61.

The only significant condition placed on Citigroup is a requirement that for the next three years it pay no more than a penny per share annually in stock dividends. This, however, is only a small penalty for big shareholders, whose equity investments would have been wiped out had the bank been allowed to fail.

Neither the government nor Citi sought to conceal the extraordinarily lenient terms of the deal. The 8 percent dividend on the preferred shares is lower than what private shareholders have been offered.

Government officials said they did not want to impose punitive terms on Citigroup because its stability was crucial to protecting the financial system. Citigroup’s chief financial officer, Gary Crittenden, repeated the same line, saying the agreement “was not about punitive, it was about financial stability.”

Crittenden added that the deal was deliberately packaged in “a plain vanilla flavor” so it could be applied to other lending institutions.

Wall Street applauded the bailout, sending share prices soaring on Monday. The Dow Jones Industrial Average surged 397 points, a gain of 4.9 percent. The other major indexes also rose sharply, with the Standard & Poor’s 500 Index climbing 6.5 percent and the Nasdaq Composite Index gaining 6.3 percent. On top of Friday’s surge following the announcement that Geithner would be Obama’s treasury secretary, Monday’s close marked the biggest two-day rally since 1987.

Citigroup stock, which had plunged 60 percent just last week to a 16-year low of \$3.77, bringing its decline to 87 percent over the past year, climbed 58 percent. Other financial stocks also rose sharply, with JPMorgan Chase and Bank of American jumping more than 21 percent.

Citigroup, just two years ago the largest US bank by market value, came to ruin over the past 16 months as a result of its aggressive involvement over previous years in the highly lucrative subprime mortgage market. At the bidding of its senior counselor and board member, Robert Rubin, who joined Citi after ending his stint as treasury secretary in the Clinton administration, the bank took on added risk in order to increase profits. From 2003 to 2005, Citigroup more than tripled its issuance of collateralized debt obligations (CDOs)—securities based on bundles of subprime and other risky loans—to more than \$20 billion from \$6.28 billion, making Citi one of the industry’s biggest players.

As one person who worked in the bank’s CDO department told the *New York Times*, “As long as you could grow revenues, you could keep your bonus growing.”

When the credit and housing bubbles collapsed in the summer of 2007, Citigroup was hit with massive losses. It has to date registered more than \$65 billion in losses, write-downs for bad assets and charges for future losses, more than half from mortgage-related assets. It reported net losses of \$20 billion over the last four quarters.

Obama’s economic team, it should be noted, is staffed by Rubin protégés, including Lawrence Summers as his top economic adviser, Geithner at Treasury, and Peter Orszag, his pick to head the Office of Management and Budget.

Despite the market surge on Monday, it is unlikely that the government bailout will solve Citigroup’s solvency problem. It is the world’s largest issuer of credit cards, and the surge in unemployment is certain to result in a flood of defaults on credit card and other forms of consumer debt, further undermining the bank’s balance sheet. In addition, Citi has \$1.21 trillion in entities that are not reflected on its balance sheet, some of which are tied to mortgages and will likely have to be brought back onto the bank’s books. Its large holdings in commercial real estate are being hit by defaults in that sector. Finally, Citigroup is heavily invested in so-called emerging markets, which are sliding rapidly into recession.

The same, to a greater or lesser extent, can be said of virtually all of the major US banks. The financial crisis triggered a deepening slump in the broader economy, which is now feeding back once again on the banking system, making inevitable further banking panics and more huge government bailouts. Citigroup itself could very well be returning for a new infusion of taxpayer money.

For their part, the Treasury and the Fed are in a state of disarray and perplexity. Just last Tuesday, Treasury Secretary Paulson told a congressional committee that the government had “turned the corner as far as stabilizing the system” and said he did not plan to announce any new rescue efforts from the \$700 billion bailout program. Now he is preparing to ask Congress to authorize the remaining half of the \$700 TARP fund and preparing to launch new rescue schemes to stave off a collapse in the consumer credit markets.

While the government hands out trillions to the banks, virtually nothing is allocated to provide relief for millions of workers who are losing their jobs, their homes and their life savings. Instead, the banks that are receiving the government handouts are ruthlessly shrinking their workforces. On November 17, a week before it received its bailout from the government, Citigroup announced plans to slash 52,000 jobs over the next several months. By early next year, the company is expected to reduce its worldwide workforce to 300,000, down 20 percent from a high of 375,000 workers in 2007.



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