

Citicorp bailout leaves debt as unpayable as ever

by John Hoefle

Anyone who still doubts that the government and the news media continue to lie about the disastrous state of the U.S. economy, should take a close look at a May 16 *Washington Post* story, "The Saving of Citibank."

The article, which was featured on page 1, revealed what the paper described as "an extraordinary two-and-one-half-year partnership between [Citicorp Chairman John] Reed and the regulators to rescue the nation's biggest bank and avoid worldwide financial turmoil. . . . The Citicorp saga provides a case study of how financial regulation works in a crisis—subtly, secretly and, in this case, successfully—to nudge a giant bank back from the brink."

While readers of *EIR* have known about the secret takeover of Citicorp since November 1991, this extraordinary effort to bring the giant bank "back from the brink" must have come as quite a shock to nearly everyone else, especially those gullible enough to believe the regulators' frequent pronouncements that the U.S. banking system is solvent.

During the speculative frenzy of 1980s, the nominal assets of the U.S. banking system soared. Citicorp's assets grew by more than \$100 billion during that period, or nearly as much in one decade as it had in the preceding 168 years of its existence. Citicorp was a major lender in nearly every aspect of the bubble, from the real estate market—43% of all the office space ever built in the United States was constructed during the 1980s—to the leveraged buyout boom, which cost the United States hundreds of thousands of jobs; to the massive increase in derivative and other trading activities.

To anyone who understands the difference between financial speculation and the real economy, it was obvious that the banks were lending hundreds of billions of dollars for all sorts of absurd schemes, and that most of those loans could never be repaid.

The 'bubble bank'

Citicorp was in many respects the epitome of the 1980s bubble bank, pouring money into what would become the biggest financial disasters, thus far, of the 1990s. Citicorp was a major lender to Robert Campeau's Campeau Corp., which filed for bankruptcy in 1990. Citicorp was forced to close its Citicorp Scrimgeour Vickers operation in the City of London, after massive losses. Citicorp lent billions to a string of bankrupt real estate developers, including New York's Donald Trump, Atlanta's John Portman, the United Kingdom's Mountleigh and Randsworth Trust, and the biggest failure of them all, the Reichmann Brothers' Olympia & York. Everywhere one finds a disaster, it seems, one also finds Citicorp.

According to the *Washington Post*, the regulators' "co-management" of Citicorp began on Nov. 14, 1990, when Federal Reserve Bank of New York President Gerald Corrigan and Federal Reserve director of bank supervision William Taylor summoned Reed to New York. The U.S. banking system was headed for trouble and so was Citicorp, they told Reed, due to the sharp decline in the real estate market. Were Citicorp's troubles to become widely known, the regulators warned, it could trigger a run that could bring down not only the bank, but the entire financial system.

Citicorp's problems were already well known in the financial community, however. In March 1990, Citicorp had announced that it was dramatically curtailing its lending for large real estate projects, after its admitted bad real estate loans rose 112% the previous year, to \$1.2 billion from \$548 million, and foreclosures rose 66%.

In April 1990, IBCA Banking Analysis, the London-based bank rating agency, declared that Citicorp was "undercapitalized and under-reserved," citing the bank's real estate

problems, its leveraged buyout loans, and its Third World debt. Later in the month, Standard and Poor's downgraded Citicorp, citing the bank's inadequate loan loss reserves. In May, Moody's Investors Services also downgraded the bank.

In July 1990, Citicorp announced its third major reorganization of the year, this time involving dramatic cuts in its foundering global finance division, where problem loans had tripled in one year. The same month, bank analyst Dan Brumbaugh told the ABC News broadcast "Nightline" that Citicorp was insolvent, along with Chase Manhattan, Chemical Bank, Manufacturers Hanover, and Bankers Trust.

By October 1990, investors were so nervous, that a Citicorp auction of money-market securities would have failed, had not the underwriter, Goldman Sachs, stepped in with a bid. Another auction two days later was successful, only because Citicorp paid an embarrassingly high 13% yield.

It was against this backdrop, with the bank insolvent and sinking fast, that regulators stepped in with their November covert takeover of Citicorp, ordering the bank to sell assets, cut expenses, and raise new capital.

Treading carefully

The intent of the regulators to move slowly was obvious in December, when the bank announced it would add a token \$340 million to its loan loss reserves for the fourth quarter. After the addition, Citicorp had reserves equal to 21% of its non-less developed countries, non-performing loans, compared to an average of 50% at the other big New York banks—which were also under-reserved.

Responding to the ignominious seizure, former Citicorp Chairman Walter Wriston, the man most responsible for Citicorp's trip down "bubble lane," wrote a commentary in the Dec. 19 *Wall Street Journal* blaming federal banking regulators for "creating a system to produce bank failures." The article was aptly titled "No Wonder Banks Fail."

During 1990, Citicorp's market value fell a staggering 55% to \$5.4 billion, giving it a market value less than that of J.P. Morgan & Co., despite having twice Morgan's assets.

In January 1991, Reed announced plans to boost the bank's equity capital by \$4-5 billion over the next few years—a 50% increase over the \$8.6 billion in equity the bank claimed at the end of 1990—while slashing expenses by \$1.5 billion. The bank was reportedly seeking to raise \$25 billion through capital infusions and asset sales. "The marketplace feels we are not adequately capitalized, and I would acknowledge that the Federal Reserve thinks we are not adequately capitalized," Reed admitted to a meeting of bank analysts in New York on Jan. 22, 1991.

In late February 1991, Saudi Prince al-Waleed bin Talal, who already owned 4.9% of Citicorp thanks to a buying spree in late 1990, agreed to buy \$590 million of new Citibank preferred stock, and in early March, Citicorp raised another \$600 million from a group of Mideast and U.S. institutions, for a total of \$1.2 billion in new capital in two weeks. The new

stock offerings, which reportedly paid after-tax yields of over 20%, diluted the existing shareholdings by some 17%.

The new capital, however, barely put a dent in Citicorp's growing losses. The bank's non-performing commercial real estate loans, for example, rose to an admitted \$2.9 billion in the first quarter of 1991, more than double the \$1.3 billion reported a year earlier.

Technically insolvent

The bad news just kept growing. In hearings on the Bush administration's banking bill on July 31, 1991, House Energy and Commerce Committee Chairman Rep. John Dingell (D-Mich.) said that Citicorp was "technically insolvent" and "struggling to survive." Dingell also reported that the bank had been borrowing heavily from the Federal Reserve. Dingell's remarks spread rapidly through the financial community, triggering runs against Citicorp in Hong Kong, Pakistan, and Australia.

Citicorp angrily denied the comment, calling it "irresponsible and untrue." Added William Seidman, chairman of the Federal Deposit Insurance Corp. (FDIC), which was involved in the secret bailout, "I don't believe it is insolvent under any standard."

During fall 1991, the Fed dropped its discount rate to record lows to help the struggling U.S. banking system, and Citicorp in particular. This rigging of interest rate spreads has been a central feature of the Fed's massive bailout operation, which continues to this day.

As bad as 1991 was, 1992 was even worse. What was left of Reed's management structure was dismantled. H. Onno Ruding, former head of the International Monetary Fund's Interim Committee, was brought in to head Citicorp's global wholesale business, where he could calm foreign depositors and the derivatives market. W. Neville Bowen, the former head of Hill Samuel's private banking group, was brought in to head Citibank Global Asset Management, which caters to wealthy international depositors. Reed remained, but with no real power.

In the spring and summer, the bank was hit with a series of disasters: the collapse of Olympia & York and Mountleigh; the bankruptcy of Alexanders department store, which the bank had taken over from Donald Trump in March; the writing off of some of the Randsworth Trust losses; and the growing troubles in the Edper Bronfman empire.

In August, a Comptroller of the Currency report showed that Citicorp's mortgage unit was bankrupt, having been run in an "unsafe and unsound" manner, with mortgage delinquencies running four times the national average. The situation was so bad, the report said, that the Federal Home Loan Mortgage Corp. (Freddie Mac) had stopped buying Citicorp mortgages.

Now, regulators and the *Washington Post* would have you believe that Citicorp has been saved and that the U.S. banking system is "back from the brink." They're still lying. Despite the bailout operations, the debt still can't be paid. It just keeps growing.