

Citigroup, Bank of America May Look 'Nationalized' (Update3)

By Ari Levy

Jan. 23 (Bloomberg) -- The U.S. government's decision to pledge billions of additional dollars with strings attached to Citigroup Inc. and Bank of America Corp. may be nationalization by another name, according to former bankers and regulators.

Faced with pressure from lawmakers, banks have shaken up management, eliminated executive bonuses and staff and canceled conventions. They'll be forced to do monthly reports on how they've boosted lending while slashing quarterly dividends to one cent a share for three years.

"When the Treasury tells a bank to pay a penny a share vs. its old dividend, you know who's calling the shots," said Jon Bruss, a 40-year industry veteran and founder of Hartland, Wisconsin-based Fortress Partners Capital Management Ltd., which invests in banks. "It may not be de jure nationalization but I think it's de facto nationalization."

While avoiding steps taken by the U.K., which this week acquired a 70 percent stake in Royal Bank of Scotland Plc, U.S. regulators are no longer passively injecting capital into the nation's biggest banks. Investors have fled, sending Citigroup and Bank of America down by more than 50 percent this year, on concern that tougher U.S. oversight is coming after the government takeover last year of mortgage financiers Fannie Mae and Freddie Mac, and insurer American International Group Inc.

Citigroup, based in New York, tumbled 56 cents, or 15 percent, to \$3.11 yesterday on the New York Stock Exchange. Bank of America plunged 97 cents, or 15 percent, to \$5.71. The 24-company KBW Bank Index has dropped 36 percent in 2009, following last year's 50 percent decline.

Government Decides

"Some of these traditional management decisions are being made by the government," said Donald Powell, 67, who was chairman of the Federal Deposit Insurance Corp. from 2001 to 2005, and now lives in Amarillo, Texas. "Shareholders don't have a voice in some of these things that are occurring."

After the Treasury's initial investments in October failed to adequately shield Citigroup and Bank of America from mortgage-related losses, the companies returned for more capital along with protection from hundreds of billions of dollars in potential defaults.

Citigroup needed \$20 billion in November on top of an earlier \$25 billion injection, which still wasn't enough to keep the company from splitting apart after posting a record deficit on Jan. 15. The same day, Bank of America received \$20 billion to cover losses tied to Merrill Lynch & Co. after the two companies received a combined \$25 billion in October.

Executives Depart

Citigroup replaced Win Bischoff as chairman yesterday, naming former Time Warner Inc. Chief Executive Officer Richard Parsons to the post. Two weeks ago, former Treasury Secretary Robert Rubin, who had been a top Citigroup executive and board member, announced plans to step down. Merrill Lynch head John Thain was ousted yesterday, less than a month after he negotiated the sale of his company to Bank of America.

William K. Black, former lawyer at the Federal Home Loan Bank of San Francisco and Office of Thrift Supervision, says the Treasury could do better by assuming control of the companies and removing existing management altogether. By trying to avoid nationalizing the institutions, the government is wasting money, he said.

“It’s insane to leave it in the control of the people who have every incentive to cover up the scale of the losses,” said Black, professor at the University of Missouri-Kansas City School of Law. “You’re deliberately negotiating a bad deal for the American people by not getting an appropriate return for the risk you’re taking.”

Dividends, Conferences

Investors are getting smaller returns because the banks have to cut their dividends as part of the bailout agreements. And the companies are being told how to spend their money -- especially when it comes to conferences and other business trips.

SunTrust Banks Inc., an Atlanta-based lender that sold \$4.9 billion in preferred shares to the U.S., eliminated a sales conference to hold down travel expenses and reduced compensation for 4,000 managers. AIG, which received a \$150 billion bailout package and is now majority-owned by the government, drew fire from lawmakers last year for conferences, bonuses and perks.

Bank of America rose 53 cents, or 9.3 percent, to \$6.24 at 4 p.m. on the NYSE today. Citigroup added 36 cents, or 12 percent, to \$3.47.

In the U.K., Barclays Plc is trading at a price that indicates investors give it a 70 percent chance of nationalization, according to a note today from Sanford C. Bernstein analyst Bruno Paulson in London. The stock, down as much as 20 percent today, has lost about two-thirds of its value since Jan. 12.

‘Partial Nationalization’

Citigroup and Bank of America aren’t necessarily headed toward nationalization, according to Powell, who said President Barack Obama’s administration is tasked with developing an “exit strategy” to avoid ending up with financial control. That may mean converting preferred shares into common equity and then selling them, he said.

As Obama's economic advisers plan for how the government will dole out the remaining \$350 billion in the Troubled Asset Relief Fund, they'll make sure the money doesn't go to "bonuses or remodeling" offices, White House press secretary Robert Gibbs said today. Merrill Lynch's Thain spent \$1.2 million redecorating his downtown Manhattan office last year as the company was firing employees, a person familiar with the project said yesterday.

'Weird' Policy

Another former bank regulator, Kevin Jacques, says a nationalization policy may be preferable to the current strategy of handling every case differently.

In 2008, Bear Stearns Cos. was bought by JPMorgan Chase & Co. in a deal arranged by the government, Lehman Brothers Holdings Inc. went bankrupt, Washington Mutual Inc. was seized and AIG was taken over. That hurts confidence in the financial system and keeps investors guessing, Jacques said.

"If you took a nationalization policy, you would at least create some degree of certainty because now you know the government is going to stand behind these institutions," said Jacques, 49, who was an economist with the Treasury Department for 14 years before becoming a finance professor at Baldwin-Wallace College in Berea, Ohio.

Now, "it's almost like some kind of weird partial nationalization," he said.

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