
ROBERT GROSSMAN

Citigroup: 'Gimme Shelter'

Why on earth should we **protect banks** from their mistakes?

THIS MAY SOUND SILLY, but let me ask you a question. Let's say that I maxed out my credit at Citigroup to speculate on a house whose market price is now less than what I paid. Citi wants its money, but instead I say, "Sorry, the house is selling for less than its true value. As soon as it sells for what it should, I'll send you a check." What do you think Citi's reaction would be? How about "Sir, where should I send the repo man?"

Well, folks, Citi seems to have put itself in just such a fix by borrowing lots of money to buy assets that have dropped in market value. But instead of summoning the repo (as in repossession) man, some of the world's biggest hitters are trying to set up a huge fund to buy time for Citi and some other institutions with similar problems.

IF CITI CAN'T LIQUIDATE ITS SIVs WITHOUT A PROFIT HIT, TOO BAD.

The idea is to set up a $100 billion "master liquidity enhancement conduit" to take some of the $80 billion of suspect securities off Citi's hands so that it doesn't have to sell them in the current market. Other institutions have about $300 billion worth. (This conduit is being called a superfund, to the delight of those of us who live in New Jersey, for whom the term evokes images of toxic industrial waste. But I digress.)

The problem here, as you probably know, involves seven of Citi's "structured investment vehicles," known as SIVs. They borrowed short-term money to buy long-term assets, such as mortgage-backed securities, that have fallen in market value.

Regulators and various big institutions are trying to stabilize things to avoid what we can call SIVilis. That's a financially transmitted disease that could infect the world's financial markets, leading to cascading failures and other consequences too dire to even think about.

Citi won't talk to us about SIVs. The only player who would go on the record is Treasury Secretary Hank Paulson, whose department is in charge of maintaining orderly financial markets. The problem, Paulson told FORTUNE, is not merely "the repricing of risk" but also analyzing the immensely complicated securities the SIVs own. "What you're dealing with here is complexity," he told us, and the proposed master conduit would pool not only money but analytical information as well. An interesting concept.

Paulson wouldn't discuss Citigroup or provide details about how bad SIVilis is. But he gets points for coming out and talking.

Citi clearly screwed up with its SIVs. When a financial institution borrows short term to buy long-term assets, it's supposed to have a plan for when its bet goes bad—rather than just whining about "disorderly markets." Citi now says it has put together enough borrowings to carry its SIVs through year-end, which may be why Paulson told us the problem "isn't urgent."

If Citi's only problem is that it can't liquidate its SIVs without a profit hit, too bad. If Citi's very existence is at risk, I don't think we dare let it fail, because that would drag down institutions throughout the world. But if the bank needs help, its shareholders should have to pay. Bigtime. Step one would be to eliminate its common stock dividend, currently more than $10 billion a year. Step two would be to force Citi to raise the capital it needs by selling new stock at a price well below its recent $42 a share. That would force holders to either ante up or have their Citi stake diluted. That just might inflict enough pain on shareholders that someone other than underlings would pay for Citi's SIV sloppiness.

In any event, if we believe in markets, Citi should have to take its chances. We small fry take chances when we borrow, and we pay the price if we're wrong. Big fish should have to do the same. ■

FEEDBACK *asloan@fortunemail.com*