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America's most political bank

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In the turbulent history of American banking, one institution looms larger than the rest.

Take a momentous event in US history — the end of slavery, the country's breakneck industrialisation, its infatuation with the stock market in the 1920s, and the recent mortgage meltdown — and chances are that two-hundred-year-old Citi was involved: sometimes bankrolling the government, other times frantically knocking at its door for help; sometimes a prudent steward of financial stability, others enabling the punters' most outlandish bets.

For two centuries, the fortunes of Citi have been conflated with the fate of the country more than most politicians and regulators would care to admit. James Freeman and Vern McKinley's *Borrowed Time: Two Centuries of Booms, Busts, and Bailouts at Citi*, a formidable deep dive into the vicissitudes of this largest and most controversial of American banks, reveals just how dependent Citi became on the leniency of government officials — and how handsomely the bank repaid their largesse.

Citi is infamous as the biggest beneficiary of the various bailout programs orchestrated by the Federal Reserve and other financial regulatory bodies during the 2008 financial crisis. All told, the bank secured official support worth $517 billion between late 2007 and early 2009 — a whopping 25 times shareholders' equity.

While the scale of the rescue may have been unprecedented, Freeman and McKinley show that it was by no means the first time Citi relied on government forbearance and funding to remain a going concern. *Borrowed time* documents how the bank would have struggled to survive the painful hangover from the Roaring Twenties boom and the emerging market rout of the 1980s without preferred treatment from regulators.

Things were not always like that. The City Bank of New York was founded in 1812 as a private replacement for the First Bank of the United States, whose charter the US Congress had refused to renew. It immediately made itself useful to the American government, by helping to finance the fledgling republic's war with Britain that year.

Boom times followed, as states borrowed to build infrastructure and worldwide demand for cotton fuelled American growth. But the expansion was cut short when President Andrew Jackson, aided by Bank of England tightening, caused a dramatic drop in the number of circulating banknotes.

The resulting depression put the thinly capitalised City Bank on the brink of insolvency, forestalled only by a timely capital infusion from New York tycoon John Jacob Astor.

Astor installed his protege Moses Taylor as a bank director, a position from which Taylor imbued City with a philosophy of “ready money”: the bank was to hold high levels of capital and a preponderance of liquid assets. Taylor’s mantra, combined with industrial growth and a role as the federal government’s broker of choice for Civil War bond issues, helped to turn City Bank into America’s financial powerhouse, counting oil magnate J.D. Rockefeller among its customers.

It was around this time that political entanglement became a defining feature of the bank. In 1901, City hired Assistant Treasury Secretary Frank Vanderlip as its vice-president, a move echoed nearly a century later when outgoing Treasury Secretary Robert Rubin was put on the payroll. At the helm of the institution in due course, Vanderlip would help to craft the Federal Reserve Act by which Congress established a U.S. central bank.

Perhaps more significantly, Vanderlip initiated City’s expansion into foreign markets, which at a time of extensive branching restrictions was one of the few ways that American banks could diversify their operations.

However, foreign ventures proved risky on the eve of World War I, and City Bank was forced to take heavy losses on its Cuban and Russian subsidiaries, battered respectively by a sugar glut and a communist revolution.

Luckily, the Federal Reserve, in many ways Vanderlip’s baby, was now around to supply ready cash to his bank during the credit crunch.

From then on, City Bank came to rely on the government’s implicit guarantee. Risky loans at home and abroad put the bank in a precarious position when the stock market crashed in 1929, necessitating Fed support to eschew bankruptcy. City was widely blamed for the collapse, and the 1933 Glass-Steagall legislation that separated commercial and investment banks was informed — however misguidedly — by the view that banks should not combine supposedly safe retail activities with speculation in stocks.

This separation did not, however, act as a prophylactic against future risk-taking. The 1960s and ’70s were go-go years in which City lent profusely to American industry and Latin American governments buoyed by rising commodity prices. When the bill came due, overextended City Bank’s only resort was the U.S. government’s willingness to stand behind it. Fortunately for the bank, this commitment remained strong.

Thus when Treasury Secretary Hank Paulson said, in the febrile environment of late 2008, that “if Citi isn’t systemic, I don’t know what is” he was not so much stating the obvious as rationalising eight decades of official government policy to underwrite the risks of one bank.

Freeman and McKinley’s achievement is to present the long-lived symbiosis between Citi and its overseers, not as the product of evil intentions or unreasonable size, as so many critics of banking are apt to suggest; but rather, as the complex interplay between poor risk management, distorted incentives, and political quid pro quo. There is no easy fix to what *Borrowed Time* calls “America’s most political bank.”

Nevertheless, the discerning reader will not put down this book thinking that Citi has been, always and everywhere, a source of mischief. Indeed, the bank's history features many shining moments, from its unacknowledged role calming markets during the 1907 panic, to the extension of consumer finance and retail investment that it facilitated, to the end of Glass-Steagall — by then an irredeemable relic — that the bank's merger with Travelers in 1998 precipitated.

Indeed, one is left wondering whether Citi is that different from its competitors after all, or whether it simply became America's most political bank by dint of being the largest. Freeman and McKinley seem to believe that such equanimity is undeserved, quoting former FDIC chairwoman Sheila Bair that "some are coming to Washington for help, others are coming to Washington to help." Still, that begs the question: to help whom, and in exchange for what?

There as elsewhere, Citi's trajectory merely reflects the tortuous evolution of US financial regulation.

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