

## **Citigroup: Restoring Ethics and Image Before Growth**

Charles Prince, CEO of Citigroup, is facing a daunting challenge as the head of the largest financial services organization in world. He has joined a company that has experienced significant regulatory scrutiny and that has been linked to the biggest scandals in corporate history. Unfortunately for Prince, the problems are pervasive throughout most of Citigroup's diverse service offerings.

In March 2005, Prince announced his strategy to transform the financial giant and to provide a new direction for the future. He called it the "Five Point Ethics Plan" to: improve training, enhance focus on talent and development, balance performance appraisals and compensation, improve communications, and strengthen controls. Due to the size and complexity of the organization, there were significant unresolved questions. How could the plan be effectively revealed? Would the plan be strong enough to change the culture of the entire organization? How should the corporate communications department handle both the initial and long-term communication of this plan to major stakeholders?

### **About Citigroup**

Incorporated in 1998, Citigroup Inc. is a diversified global financial services holding company providing services to consumer and corporate customers. The company has approximately 141,000 full-time and 7,000 part-time employees in the United States and 146,000 full-time employees in more than 100 countries outside the United States. All of Citigroup's services can be grouped in 3 main areas: Global Consumer, Corporate and Investment Banking, and Global Wealth Management. Citigroup also has two stand-alone businesses, Citigroup Asset Management and Citigroup Alternative Investments. Global Consumer Group was 72% of income in 2004, with Investment Banking coming in second at 13%.<sup>1</sup>

The Citigroup umbrella covers several brands including Citibank, Citifinancial, Citistreet, Citi, Primerica, Banamex, and Solomon Smith Barney (SSB). Citigroup has a 200 year old legacy of innovation and achievement. The City Bank of New York is Citigroup's earliest ancestor, establishing a credit union for merchant-owners in 1812. Many of the rest of Citigroup's ancestors originated in the late 19<sup>th</sup> century, including Travelers, Smith Barney, Bank Hadlowly, and Banamex. In the 20<sup>th</sup> century, acquisitions included IBC, Salomon Brothers, and The Associates. Sandy Weill, former CEO, was recognized as bringing it all together under the one red umbrella of Citigroup in 1998.<sup>2</sup>

### **Sandy Weill: The Man Who Shattered the Glass-Steagall**

"Everything about Weill is big, including his ambition"  
Charles Gasparino, *Blood on the Street*

Congress passed the Glass-Steagall Act in 1933, which established what was known as the Chinese Wall between commercial banking and investment banking. That same year, the man

who would influence the repeal of that act in 1999 was born. Sandy Weill later became one of Wall Street's most influential men as the Citigroup CEO in 1998. He ran the one-stop financial supermarket until 2003.<sup>3</sup>

In the 1960s, Weill grew Shearson Loeb Rhodes brokerage from a mid-sized business into an empire that he sold to American Express Corporation in 1981. After being bounced from Amex, he had one of the most notable comebacks on Wall Street. He merged his insurance company, The Traveler's Group, with the Salomon Smith Barney brokerage and the Citicorp banking empire. This merger made Weill a very rich and powerful man, but the fame also brought a lot of negative publicity. During Weill's era as CEO, Citigroup was associated with numerous corporate scandals, regulatory investigations and legal settlements.

In an interview with the *New York Times* on September 11, 2005, Weill still defended what he built, saying "I don't think it's too big to manage or govern at all. I'm sure there would have been things that would have been tweaked this way or that way, but when you look at the results of what happened, you have to say it was a great success."

Charles Prince became the next Citigroup CEO after Weill. His advice for Prince, "Don't screw (the legacy) up."<sup>4</sup>

### **Charles Prince – Maintaining the Legacy**

Charles Prince became the chief executive officer with Citigroup in 2003 and has been an employee with the company for 24 years. He began his career in 1975 as an attorney with U.S. Steel Corporation. In 1979 he joined Commercial Credit Company, which Sandy Weill took over in 1986. At that point, Prince became what *Fortune's* Carol Loomis called, "an absolute Weill loyalist, who has promptly accepted whatever assignments Sandy has wanted him to take on."<sup>5</sup> He served as main counsel until 2003, when Weill chose him as CEO. Since 2003, Prince has been a fireman, cleaning up the scandals and improprieties that have been building since the late 1990s. Much of that cleaning has meant removing companies and executives that helped build Weill's legacy, including the sale of Traveler's Insurance.

Prince has been described as "a smart, logical thinker who's big in frame, in laugh, and in capacity for work." One long-time analyst notes, "I believe that non-charismatic Prince is going to be a more positive force at Citigroup than the other three charismatic CEOs going back to the 1960s."<sup>6</sup>

### **Distributing Biased Research**

In 2001, the Office of New York State Attorney General Eliot Spitzer began an investigation into possible conflict of interest problems with Citigroup's investment banking practice. This joint investigation between state and federal regulators was resolved and settled in April 2003. In addition to payment of \$400 million, Solomon Smith Barney (SSB) was required to adopt a

series of reforms and measures. This payment was larger than any other financial institution included in the investigation. The financial impact is even larger due to additional private litigation arising from the settlement. Citigroup took a \$1.5 billion charge primarily for litigation reserves in the quarter of the findings.<sup>7</sup>

There were multiple findings from the investigation concerning Citigroup's internal operating practices and communications with clients. The investigation found that the research analysis and correlating ratings were not performed with independence and integrity. SSB business practices encouraged research analysts to provide favorable coverage of companies that were also investment banking clients. A portion of each analyst's compensation was based on revenues from the investment banking unit and investment banking evaluations. The investigation found incidents of fraudulent and misleading research reports. SSB also practiced spinning activities that allocated lucrative shares of IPO stocks to executives at investment banking clients.<sup>8</sup>

One of the most notable reforms required as part of the settlement was to separate the investment banking operations from the research operations of the company. Senior investment banking executives working for a client were forbidden from directly communicating with the research analysts covering the same client. The reforms also required the CEO of SSB's research unit to periodically report to the Citigroup board of directors concerning the quality and independence of the research products.

### **The Star Telecom Analyst**

Jack Grubman was a notorious telecommunications analyst for Solomon Smith Barney. He touted his relationships throughout the industry and earned an estimated \$20 million per year. In 10 different deals, he helped SSB earn \$24 million in fees from investment banking with WinStar Communications.<sup>9</sup>

In January 2001, Grubman assigned a \$50 price target and classified WinStar with a "Buy" rating. With the stock subsequently trading at \$13, Grubman's assistant e-mailed a large investor stating, "Buy here and sell in the low \$20's." However, Grubman did not change his price target or rating in public. In fact, he maintained the status quo even when WinStar shares were trading at less than one dollar and the company was on the eve of bankruptcy. He later noted in e-mail, "we support our banking clients too well and for too long."<sup>10</sup>

The National Association of Securities Dealers alleged that SSB's research was materially misleading after investigating the WinStar incident. SSB agreed to pay \$5 million to settle the charges.

## **Deceptive Lending Practices**

Citigroup acquired Associates First Capital Corporation and Associates Corporation of North America in November 2000. They subsequently merged the acquired entity into the Citifinancial Credit Company division. The Associates were one of the nation's largest subprime lenders. Subprime lending serves borrowers who cannot obtain credit in the prime market. The loans carry higher costs due to the additional risk taken by the lender and are frequently held by low-income families.

In March 2001, the Federal Trade Commission filed suit against Associates for deceptively inducing consumers to refinance existing debts into home loans with high interest rates and fees. They also alleged that Associates tricked borrowers into purchasing high cost credit insurance without their knowledge. In some cases, the fees were included in monthly payments and added thousands of dollars in additional cost. When consumers noticed the fees, the employees of Associates employed various tactics to discourage them from removing the insurance. The FTC described the activities as, "systematic and widespread deceptive and abusing lending practices." The result was the largest consumer protection settlement in FTC history and required Citigroup to pay \$215 million.<sup>11</sup>

## **Helping Enron Corporation Commit Fraud**

On December 2, 2001, Enron filed for bankruptcy protection from its creditors. Investors later found that the company used highly complex special purpose entities and partnerships to keep \$500 million off of the consolidated balance sheet and to mask significant deficiencies in cash flow. Citigroup was one of the financial institutions that helped Enron design these transactions.

The Securities and Exchange Commission initiated enforcement proceedings with Citigroup for assisting Enron in producing misleading financial statements. The Commission alleged that loans to Enron were disguised as commodity trades. The transactions were essentially loans because they eliminated the commodity price risk. Under these transactions, commodity price risk was passed from Enron to Citigroup and back to Enron. Without regard for the change in price of the underlying commodity, Enron was required to make repayments of principal and interest. The commission also alleged that Citigroup helped Enron design transactions that transferred cash flow from financing into cash flow from operations. There was further evidence of similar deceptive transactions with Dynegy. Citigroup agreed to pay \$120 million to settle the allegations that it helped Enron and Dynegy commit fraud.<sup>12</sup>

## **Spinning WorldCom Executives**

In May 2004, Citigroup agreed to pay \$2.65 billion to settle class action suits related its role in the collapse of WorldCom. Plaintiffs in the suit alleged that SSB wrongfully provided favorable ratings on the company. Telecom analyst, Jack Grubman, provided the coverage. WorldCom was not downgraded to "neutral" until WorldCom lost 90% of its value. The U.S. House of

Representatives Financial Services Committee additionally found that Grubman warned WorldCom executives, in advance of public disclosure, that Citigroup was dropping the stock from the recommended list.<sup>13</sup>

A former U.S. Attorney General appointed examiner alleged that Bernard Ebbers, WorldCom's chief executive officer, violated his fiduciary duties by passing over \$100 million of investment banking business to SSB in exchange for allotments of IPO stock shares. Ebbers was the chief executive during the time when massive accounting fraud and questionable personal loans were discovered. WorldCom subsequently restated earnings by \$17.1 billion in 2001 and \$53.1 billion in 2000.<sup>14</sup>

### **The End of Japanese Private Banking**

Citigroup is the largest and oldest foreign-owned bank in Japan. The history of their operations dates back to 1902. The operations in Japan are some of the largest outside of the U.S. for Citigroup. Bank officials at Japan's Financial Services Agency began investigating Citigroup transactions linked to money laundering, as well as loans that were used to manipulate publicly traded stocks. The FSA warned Citigroup in 2001, but little corrective action was performed.

In December 2004, Citigroup was handed the damaging news that the FSA would terminate all private banking operations in Japan. This included a requirement to close over five thousand bank accounts. The FSA cited the corporate culture and governance for the infractions. Citigroup executives blamed the problem on the unclear reporting structure for key executives in Japan. Heads of divisions reported to different bosses in New York. In addition to the lost earnings, the closing of the bank accounts represents a challenging blow to Citigroup's image in Japan and threatens the consumer and corporate banking units still operating in the country.<sup>15</sup>

### **Financial Effects of the Corporate Scandals**

By the end of 2002, the effects of the various allegations were weighing heavily on Citigroup. The SEC, FTC, NASD, the New York State Attorney General and other agencies had performed investigations. The reserves set aside for still outstanding legal liability grew by billions because of the costs of regulatory and private litigation.

During 2002, the year that many of these issues were discovered, the company lost over 30% of its market value. In May 2003, Citigroup dropped coverage of 117 firms and fired seven of its top analysts. There was an increasing number of analyst layoffs up and down Wall Street. J.P. Morgan, Goldman Sachs and Morgan Stanley cut up to 25% of their research staffs.<sup>16</sup>

In 2005, the Federal Reserve publicly announced that it would not approve any major Citigroup Mergers and Acquisitions until the company resolved these various issues. This unusual warning from the Federal Reserve was especially restrictive to Citigroup because some analysts believed that big acquisitions were the only way to continue the aggressive growth.<sup>17</sup>

## Changing Citigroup's Reputation

One of the initial steps Prince took to clean up Citigroup was hiring Sally Krawcheck as chief financial officer and head of strategy. Krawcheck was known at Smith Barney as "The Queen of Clean," and Prince hoped that she would continue this trend as Citigroup pushes to clean up its image.<sup>18</sup>

On February 16, 2005, Prince announced his Five Point Ethics Plan in a group memo to his employees as part of his goal to make Citigroup the world's most respected financial institution. While this is the most important goal Prince gave in his public plan, there are other benefits that will, hopefully, come with this ethical improvement. Prince hopes to grow the consumer and international business, and to make the corporate and investment bank the best in its class.

The four-page ethical document listed a series of initiatives that employees would start to see implemented in twelve-to-eighteen months, beginning March 1, 2005.

### Details of the Five Point Plan

- **Expanded Training.** This point is designed to instill an appreciation for Citigroup legacy. The ethics program was kicked off with a company-wide broadcast of *The Company We Want To Be* to relate the main three responsibilities within the company: the responsibility to clients, to each other, and to the franchise. Annual training the about history and the culture of the Citigroup franchise will be required for all levels of management. Additionally, all employees will receive Annual Ethics/Code of Conduct training.
- **Enhanced Focus on Talent and Development.** A new initiative will be launched, focusing on flexibility, 360 degree reviews, manager surveys, and business leadership seminars for senior managers. New jobs will be communicated and posted internally to encourage those with outstanding talent to stay within the company.
- **Balanced Performance Appraisals & Compensation.** Standardized performance appraisals and evaluations of all managers will be conducted annually. All compensation for business heads will be based on how Citigroup performs, not just how individual managers perform. Employees will be paid bonuses on the basis of how well they participate in training and ethics program.
- **Improved Communications.** Charles Prince demonstrated that takes this initiative very seriously, as he has traveled around, meeting with and visiting managers and employers. Citigroup wants to improve the consistent communication of values and goals. Results of any issues reported to Ethics Hotline will be discussed, and more conferences will be planned for Senior Managers.

- **Strengthened Controls.** Such control includes compliance training, risk control self-assessments, and the creation of the Independent Global Compliance function that will be responsible for ensuring Citigroup's compliance with rules and regulations.<sup>1</sup>

### **Prince Hires Administrative Ethics Officer**

Additionally, on September 26, 2005, Lewis B. Kaden joined Citigroup as Vice Chairman and Chief Administrative Officer. Kaden served as a moderator for the PBS's Media and Society seminar, including the *Ethics in America* series which won a Peabody Award. Kaden was a lawyer from Davis Polk & Wadwell, where he handled issues of corporate governance, mergers and acquisitions, and advised major corporations such as Citigroup on significant issues. Prince said of Kaden, "Lew's deep experience, insight, and integrity will be of great value as we pursue our ambitious agenda to build the most respected global financial services company. We look forward to his contributions."<sup>19</sup>

### **Reaction to the Plan**

"Ethics is something you learn as a child; teaching it doesn't make you an ethical person," said Prof. Charles Elson, director of the Weinburg Center for Corporate Governance at the University of Delaware. He did say, however, that "if (Prince's plan) can clarify blurry issues and help instill a culture of compliance to a code, I applaud it. But to teach ethics to make people ethical, that's a bit strained."<sup>20</sup> Elson went on to suggest, "The acid test is going to be sort of a no-tolerance policy for ethical violations, not just legal violations . . . . If the company demonstrates to its employees that it will not tolerate violations of its code of ethics . . . then you begin to affect a change in culture." Elson further stated that Prince's efforts were a "good start" but that he would need to distance himself from former administration that did not put compliance first. "Rethinking his board, bringing in new blood would be quite helpful," said Elson. He added that Sandy Weill must go, "I think that Mr. Weill's complete retirement from the company would go a long way to distance Mr. Prince from the earlier regime."<sup>21</sup>

### **The Departure of Weill's Army**

A few months after Prince's plan was announced, Robert B. Willumstad, Citigroup's President, COO and Director announced that he was going to leave to become a chief executive of a public company. Willumstad had a key role in creating Citigroup in 1998 with the combination of Travelers Group and Citicorp. During his tenure as Chairman and CEO of the Global Consumer Group at Citigroup, the company witnessed strong profit growth and several successful acquisitions. Willumstad worked closely with Charles Prince and Sandy Weill for years, and was very disappointed when he was not chosen as CEO.<sup>22</sup>

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<sup>1</sup> Found online at [www.citigroup.com](http://www.citigroup.com)

In the same month, Weill stated that he wanted to end his contract early, and launch a private-equity fund. There are reports that he is frustrated by Prince's Five Point Plan and the Traveler's Group transaction. One bank analyst stated, "Sandy always told me he preferred to fix things as opposed to sell them...I'm sure he hated (the Traveler's Group) sale."<sup>23</sup> Weill has decided to stay on until April of 2006 due to conflicts of interest and information access.

A month after the announcements about Willumstad and Weill, Marjorie Magner announced her plans to leave, as well. Marjorie was the chairman and chief executive of the Global Consumer Group segment of Citigroup. Magner plans to pursue a career change outside the financial services industry.<sup>24</sup> She is among the highest-ranking women at Citigroup, and her group contributed more than half of the bank's income over the last several years. Executives at Citigroup knew that Magner disagreed with Prince's plan and major changes. Prince responded to Magner's announcement by saying that she was one of the "legends who built Citigroup," and that he is "most proud" of the people she is developing, including her successors.<sup>25</sup>

On a more positive note, Saudi Prince Alwaleed bin Talal, Citigroup Inc's biggest investor, said chief executive Charles Prince would need more time to prove himself as head of world's largest financial-services firm. "This company is a giant," Alwaleed said, "You have to give him time to institute his culture and way of thinking. I'm backing them all the way."<sup>26</sup>

### **Prince's Response**

Charles Prince said of all these initiatives, "The real question is, can we execute it in a way that becomes more embedded? The systems are designed to provide sticks. This will all tie to how you pay people. People who don't complete the required training, for example, won't receive bonuses. If we don't pay people the right way, the initiatives risk becoming no more than cynical happy-talk."<sup>27</sup> Prince acknowledged that he has to *own* this program. He said, "If we delegate this to the (human-resources) department, it's not going to work".<sup>28</sup>

### **Discussion Questions**

1. Has Citigroup grown too large to enforce corporate governance or internal controls? What effect has the organization's size and complexity had on the continued problems?
2. What effect will the new plans have on Citigroup's investors? What can Citigroup do to mitigate negative responses?
3. How can Citigroup continually communicate the reformed organizational culture to the public?

4. How would you react if you were the corporate communications officer of a Citigroup competitor?
5. Do you believe it is possible to enforce an ethics program with this or any other organization?
6. As a corporation communications officer, what would be your method to communicate the plan to Citigroup employees and inspire change?
7. Is Prince's plan sufficient given the magnitude of the problems facing Citigroup?
8. Who are the critical stakeholders? How should Prince handle the stakeholders' responses and concerns?

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