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Government, Citi talk about increasing federal ownership

By Kathy Chu, Barbara Hagenbaugh and Sue Kirchoff, USA TODAY

A proposal to expand the government's stake in Citigroup is fanning fears that a federal takeover will ultimately be needed to shore up the distressed banking industry.

Citigroup (C), the third-largest bank by assets, began talks Sunday with the government about increasing federal ownership of the bank, says a source with knowledge of the matter. The government already holds \$45 billion of preferred shares in Citigroup and has agreed to share losses on \$301 billion of troubled bank assets.

The source, who declined to be named because the person is not authorized to speak publicly about the issue, said one option under discussion involves converting some of the government's preferred shares in Citigroup to common stock. This action, if taken, would boost a key measure of Citigroup's financial health and its capital levels.

The discussions come as banks struggle to raise adequate capital to cover mounting losses from toxic assets. In the latest sign of the industry's woes, JPMorgan Chase (JPM) slashed its dividend Monday to 5 cents a share from 38 cents a share. The government will begin Wednesday to "stress test" banks with more than \$100 billion in assets to determine their ability to sustain an extended economic downturn. One measure likely to get scrutiny is banks' common stock levels.

Michael Hanretta, a Citigroup spokesman, said the bank's capital levels are "very strong," but declined to say whether it's in talks with the government. The Treasury Department, in a statement, said it doesn't comment on conversations with specific banks. Banks that need to improve their capital levels, Treasury said, can apply to convert their preferred shares into a type of stock that can be exchanged for common shares.

If the government ends up taking a controlling stake in Citigroup, that would amount to "effective nationalization," because American taxpayers will be the largest shareholder in the bank, says Duke University finance professor Campbell Harvey.

The White House has said it prefers to keep the banking system in private investors' hands, rather than bringing it under government control. Still, government agencies on Monday pledged to do whatever necessary to keep the banking system running.

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Richard Bove at Rochdale Research says that if the government acquires banks and wipes out common shareholders, the public could lose trillions of dollars.

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