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# News

## Feds explore taking bigger stakes in shaky banks

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WASHINGTON - The government on Monday moved toward dramatically expanding its ownership stakes in the nation's banks - with Citigroup, the struggling titan of the industry, apparently at the top of the list.

Wall Street responded as it has with the rollout of almost every other plan to fix the financial crisis, taking a big drop and sending the Dow Jones industrials to its lowest level in a dozen years.

The Treasury Department, the Federal Reserve and other banking regulators said they could convert the government's stock in the banks from preferred shares to common shares.

The strategy, which could be applied retroactively to banks that received money in the first incarnation of the bailout, carries risks. But it avoids, at least for now, having to tap more taxpayer money or resort to full-fledged nationalization.

Citigroup - perhaps the biggest name in American banking - has approached the regulators about ways the government could help strengthen the bank, including the stock conversion plan, according to people familiar with the discussions. They spoke on condition of anonymity because they are not authorized to speak on behalf of the government or the company. A Citigroup spokesman declined comment.

The stock conversion could be available for other banks as well, the same sources said.

Regulators, reinforcing what the White House has said, insisted that keeping banks private is a priority. But federal officials are walking a difficult line because the government could still have huge stakes in banks.

Citigroup already has received \$45 billion in bailout money, plus guarantees to cover losses on hundreds of billions of dollars in risky investments.

"What we are doing here is we're creeping our way toward nationalization," said Terry Connelly, dean of Golden Gate University's Ageno School of Business.

The conversion plan would give the government greater flexibility in dealing with ailing banks. It would give the government voting shares, and therefore more say in a bank's operations.

But common shares absorb losses before preferred shares do, which means taxpayers would be on the hook if banks keep writing down billions of dollars' worth of rotten assets, such as dodgy mortgages, as many analysts expect they will.

On the other hand, common stock in banks is incredibly cheap, and taxpayers would reap gains if the banks come back to health and the stock price goes up.

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Citigroup stock rose about 10 percent Monday, its first gain in eight days. The bank has posted five straight quarterly losses, including \$8.3 billion in the fourth quarter. It is working to cut expenses, sell assets and return to a profit.

The broader market sold off. The Dow lost 250 points, closing at about 7,115. At its peak less than a year and a half ago, the Dow stood at nearly twice that. Monday's close for both the Dow industrials and the broader Standard & Poor's 500 was the lowest since 1997.

Some economists did not seem much more optimistic than investors.

"I don't think this is the end solution. It is a very haphazard way of trying to deal with the problems and simply postponing the inevitable - more bank failures and takeovers by the FDIC," said Simon Johnson, former chief economist to the International Monetary Fund and a professor at the Massachusetts Institute of Technology's Sloan School of Management.

It is also far from clear whether the Obama plan would entice private companies to step forward and invest in banks. Obama's treasury secretary, Timothy Geithner, has said using both public and private money to restore the banks to health is the plan.

"A lot of money has been thrown at the financial sector. The hope is that we're spending that money wisely and not just throwing money at basket cases, which remains to be seen," said David Ely, a banking professor at San Diego State University.

Friedman, Billings, Ramsey & Co. analyst Paul Miller said while the move toward some sort of nationalization might be a "scary proposition for investors," it is likely to provide the quickest and cheapest option to help rid banks of bad assets.

The conversion plan would eliminate the 5 percent dividend that banks already receiving bailout money are currently paying the government on its preferred shares, allowing the banks to hold on to more cash.

It also could bring banks closer to the mix of capital that the government will want to see when it starts conducting its "stress tests" on Wednesday to determine the health of banks, experts said.

A government switch to common shares would also reduce the value of shares held by existing stockholders in the bank.

Everyday bank customers probably would not notice a difference. They would be able to go about their normal banking business, and their deposits would still be federally insured up to \$250,000.

On Friday, regulators closed a small bank in Oregon - the 14th federally insured institution to fail this year. In 2008, the government seized 25 banks, more than in the previous five years combined.

Of the first \$350 billion in bailout funds, roughly \$250 billion was pledged to provide cash injections to banks. The Obama administration has not said how much of the second \$350 billion will be used for that purpose.

Monday's statement, issued by the Treasury, the Fed, the Federal Deposit Insurance Corp., the Office of Thrift Supervision and the comptroller of the currency, did not name specific banks.

"Currently, the major U.S. banking institutions have capital in excess of the amounts required to be considered well-capitalized," the regulators said.

Fed Chairman Ben Bernanke, who goes to Capitol Hill on Tuesday to provide lawmakers with an update on the economy, is likely to face tough questions over the government's bank rescue program.

The Fed last week provided a gloomy assessment on the economy, warning that any recovery would be gradual and unemployment - now at 7.6 percent, the highest in more than 16 years - would stay higher than normal into 2011.

The White House again played down persistent speculation that banks could be effectively nationalized.

"The president believes that a privately held banking system regulated by the federal government is the best way to go about this," White House spokesman Robert Gibbs said Monday.

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