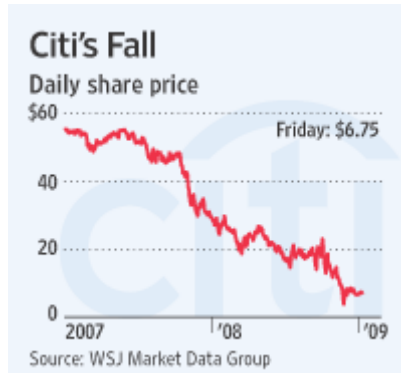


- [BUSINESS](#)
- [JANUARY 10, 2009](#)

Citigroup Takes First Step Toward Breakup

Pushed by Federal Government, Beleaguered Giant Pursues Brokerage Venture With Morgan Stanley; Robert Rubin to Retire
By [DAVID ENRICH](#)

Citigroup Inc., under pressure from the federal government, took a big step toward breaking up the financial supermarket, entering discussions to spin-off its Smith Barney brokerage unit into a joint venture with rival Morgan Stanley, according to people familiar with the talks.



News of the talks, which could result in an agreement as soon as next week, surfaced Friday afternoon as Robert Rubin, a senior counselor and director at Citigroup, announced his retirement from the New York company. The former Treasury secretary brought his high profile and respectability to Citigroup, but his reputation was diminished by his role in the financial turmoil at the bank.

The future of Sir Win Bischoff, Citigroup's chairman, is uncertain. Directors have discussed replacing him, according to people familiar with the matter. A Citigroup spokeswoman declined to comment on Sir Win.

With Mr. Rubin leaving and Smith Barney likely to be hived off, Citigroup Chief Executive Vikram Pandit, his top lieutenants and directors are weighing other possibilities that could result in a radical reshaping of one the world's largest financial-services firms.

Citigroup has also considered the sale of Grupo Financiero Banamex SA, its Mexican banking business, but that option has been shelved, according to people familiar with the situation. Citigroup officials also are mulling the creation of a new entity that would hold loans and other troubled assets, those people said. That would improve the appearance of Citigroup's balance sheet, and possibly make it easier to sell the bad assets.

Uniting the brokerage units of Citigroup and Morgan Stanley would represent another dramatic turn in the reshaping of Wall Street since the credit crisis erupted in 2007. Some experts say such a joint-brokerage venture eventually could become a standalone company. That would mark the return of powerful, independent brokerages, which all but disappeared over the past decade as investment banks and commercial banks snapped up those firms, seeking greater diversity.

More

- [Rubin Departs Citi on a Low Note](#)
- [Deal Journal: A Good Deal for Smith Barney?](#)
- [Heard on the Street: Vikram Pandit Gets Busy](#)
- [Citi's statement and Rubin's letter](#)
- [Rubin, Under Fire, Defends His Role at Citi](#)

11/29/08

- [Citi's Rubin Is Now 'Senior Counselor'](#)
08/26/08
- [For Rubin, Pressure's On](#)
- [Video: Rubin Speaks at WSJ CEO Council](#)

Behind the dramatic moves at Citigroup is mounting pressure from the federal government, which has pumped at least \$45 billion into the company since last September. The capital infusion is intended to help the company ride out \$20 billion in losses over the past year, and the likelihood that the misery could continue as the credit crisis drags on and the economy falls deeper into recession.

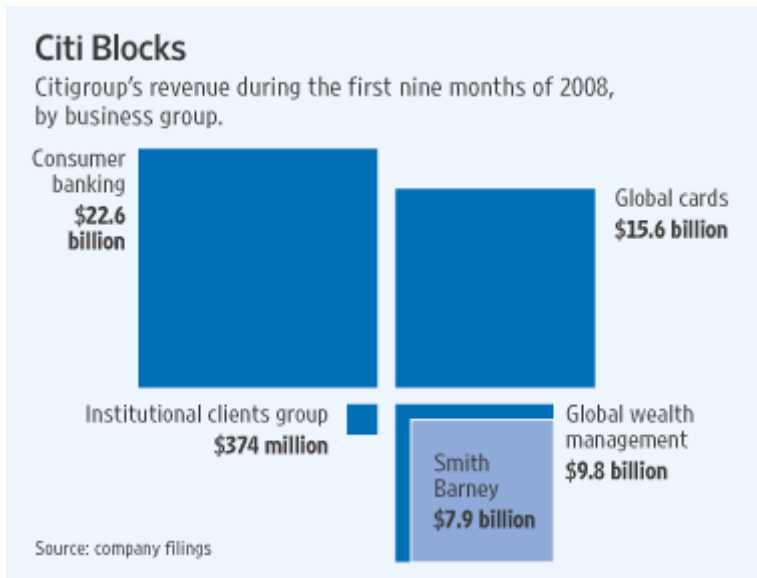
Upon being named chief executive in December 2007, Mr. Pandit said he would conduct a "dispassionate review" of Citigroup's businesses, and that no options were off the table.

But by early 2008, Mr. Pandit had started informing senior executives that he planned to keep the financial giant intact, and that his strategy revolved around improving teamwork and execution, not drastic structural changes. Last May, he unveiled his vision for the company at an investor meeting that left many observers, including top executives, feeling that he was pursuing the same approach that failed for his predecessor, Charles Prince.

Since Citigroup's shares entered a tailspin in mid-November, pressure has been mounting on Mr. Pandit to take drastic actions to stabilize the company.

In the days before the U.S. government's rescue, Citigroup executives toyed with the idea of selling or spinning off units such as Smith Barney. But Mr. Pandit was reluctant to take such steps, which he believed should only be used if all other options had been exhausted. At the time, Mr. Pandit explicitly denied that he would ditch the retail brokerage. "I love that business," he said on a Nov. 21 conference call with employees.

In December, government officials started pressing Mr. Pandit and his deputies to devise and articulate a new strategy to slim down the financial colossus, according to people familiar with the matter.



Within Citigroup, senior executives increasingly felt that Mr. Pandit's commitment to Citigroup's existing model was obsolete. Some key executives recently have concluded that some of the supposed "synergies" associated with Citigroup's current structure, such as the ability to "cross-sell" financial products to customers of different units of the company, are overstated. That made a sale of a major unit increasingly attractive.

Such a change in direction would represent a partial retreat from the strategy long championed by former chairman and CEO Sanford Weill. Starting with a small consumer-finance company in Baltimore, Mr. Weill gobbled up dozens of financial companies, culminating with the landmark 1998 merger of Citicorp and Travelers Group. That deal created Citigroup, which has tentacles in financial markets all over the world. Mr. Rubin, who at the time was Treasury secretary, facilitated the Travelers deal by

shepherding legislation through Congress that allowed the combination of commercial and investment banks. In 2002, Citigroup spun off the Travelers insurance operations.

On Jan. 22, Citigroup is likely to report a fourth-quarter loss, which Wall Street analysts are forecasting to be \$4.14 billion.

In recent days, Mr. Pandit's team has started laying plans to announce the company's intention to ditch Smith Barney as a way to ease some pain associated with the fourth-quarter results. He has been telling deputies that it is essential that Citigroup notch a profit in this year's first quarter, according to people familiar with the matter. He believes that's the only way Citigroup can reverse a dangerous decline in morale among employees and investors. It also would be an important step toward persuading federal officials that he has the company under control.



Getty Images

Rubin and former Fed Chairman Alan Greenspan visit after a panel discussion, at Georgetown University in March.

The recent activity appears intended, at least in part, to defuse mounting pressure on Mr. Pandit, who turns 52 years old next week. Although he inherited a giant mess when he became Citigroup's CEO, an increasingly vocal group of shareholders and Citigroup insiders contends he didn't act quickly enough to prepare Citigroup for the brewing financial trouble.

He may face criticism that he didn't act sooner, when the businesses could have fetched higher prices. Smith Barney has lost some of its luster amid defections of some top brokers and clients, as well as its head, Sallie Krawcheck, who was pushed out in September.

Citigroup executives believe that a joint venture with Morgan Stanley would have multiple benefits. It would free up precious capital for Citigroup, while allowing the company to continue to reap a portion of the unit's earnings.

Mr. Rubin, 70, decided last month that he was ready to leave the company, according to a person familiar with the matter. That conclusion was driven by the overwhelming amount of time that his role at Citigroup was requiring, the person said. Mr. Rubin declined to comment.

Although speculation has been swirling for months about Mr. Pandit's future, the pool of potential replacements is relatively small. It is the same issue that Citigroup's board grappled with in 2007, following Mr. Prince's departure. In some ways, the job of replacing Mr. Pandit may be even tougher, now that the government owns a significant stake in Citigroup and is keeping a tight rein on its executive compensation, expenses and other activities.

Under terms of the deal being discussed between Morgan Stanley and Citigroup, Morgan Stanley would pay about \$2.5 billion for a 51% stake in the joint venture, with Citigroup retaining a minority stake. Morgan Stanley would have the opportunity to buy more of the brokerage firm in about three years, eventually getting an opportunity to own the whole thing.

Such a deal would unite 8,000 brokers from Morgan Stanley with more than 11,000 from Smith Barney. That would push the combined group of financial advisers ahead of the former Merrill Lynch & Co., which has about 16,000 brokers and was acquired by Bank of America Corp.

Both Citigroup and Morgan Stanley have been looking to reinvent their businesses after deep losses and a slowdown in their core businesses. Morgan Stanley agreed to turn itself into a commercial bank last year after hedge-fund clients fled and the company's short-term funding model looked unstable.

Morgan Stanley is eager to boost its presence in serving individual investors. A larger brokerage force would help Morgan Stanley reduce its exposure to trading and other volatile businesses.

—Matthew Karnitschnig, Aaron Lucchetti and Robin Sidel contributed to this article.

Write to David Enrich at david.enrich@wsj.com