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Fed Assesses Citigroup Unit $70 Million In Loan Abuse

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The Federal Reserve said yesterday that it had ordered a unit of Citigroup to pay $70 million for abuses in personal and mortgage loans to low-income and high-risk borrowers nationwide. The penalty is the largest ever imposed by the Fed, the nation's leading bank regulator, for consumer lending violations.

The fine reflects the severity of the problems in the consumer finance subsidiary, CitiFinancial, and concerns that employees tried to mislead the Federal Reserve Bank of New York after it began investigating the abuses in 2001.

Regulators rely on banks to provide accurate, timely information about operating problems and to cooperate with examiners on inquiries and audits. When bank employees do not do so, this can produce unusually harsh responses from regulators who, at least in the recent past, seemed inclined to settle compliance problems quietly and behind the scenes.

The Federal Reserve said CitiFinancial engaged in ''unsafe and unsound'' practices by converting personal loans into home equity loans without adequately assessing borrowers' ability to repay. The activity did not focus on any particular region of the country.

Banks that engage in predatory lending practices often assess the value of the collateral associated with a loan, rather than a borrower's ability to repay, as part of efforts to reap high, short-term fees and then gain control of the collateral, like a home, once a borrower defaults.

But the Federal Reserve did not raise foreclosure as an issue in its action against CitiFinancial, based in Baltimore, and Citigroup typically does not pursue foreclosures as part of the home equity loans in question, according to a person briefed on the matter. The Fed issued a cease-and-desist order against Citigroup itself in relation to the abuses uncovered at CitiFinancial. It also cited CitiFinancial for violating co-applicant requirements to increase the sales volume of joint credit insurance products.

The bank said in a statement yesterday that it had already taken steps to remedy the abuses the Federal Reserve identified and acknowledged deficiencies in its practices, though it did not acknowledge any wrongdoing in the matter.

Citigroup said it had applied internal procedures to make sure that its lending units adhere to strict guidelines on a borrower's ability to repay.

Regarding charges that it misled regulators, Citigroup said in the statement that it had ''developed and disseminated an updated policy on responding to regulatory examinations that reaffirms CitiFinancial's commitment to ensuring that all examiners obtain complete and accurate information from employees.'' It commented more directly on the matter in an internal communiqué circulated to employees yesterday.

In that memo, CitiFinancial's president, Harry Goff, said: ''The Federal Reserve alleges that Citi-Financial took actions to mislead examiners in connection with their interviews of CitiFinancial field employees. CitiFinancial acknowledges that aspects of its response to the Federal Reserve examination were not handled properly.''

Citigroup said $20 million of the $70 million might be used to make restitution payments to borrowers who were misled by CitiFinancial. The bank said it expected to pay at least $30 million in restitution beyond that mandated by the Federal Reserve -- for a total of at least $100 million in fines and payments related to the consumer lending abuses.

Charles O. Prince, Citigroup's chief executive, said, ''The resolution of this matter is another important step in our continuing effort to address the issues of the past and move forward with standards that define best practices in our business.''

Mr. Prince used similar language about Citigroup's practices two weeks ago when the bank announced a record payment of $2.65 billion to settle fraud claims filed by investors in WorldCom, which had close business relationships with Citigroup before filing for bankruptcy protection in 2002.

This is not the first time that Citigroup has run afoul of regulators regarding its consumer lending practices. In 2000, it acquired Associates First Capital, at the time one of the country's largest consumer finance companies. But Associates' lending practices in what is called the subprime market, for less creditworthy customers, caused compliance troubles for the parent company later.

In 2002, Citigroup agreed to pay $215 million to about two million clients to settle Federal Trade Commission charges that Associates First Capital deceived borrowers into taking overpriced mortgages and credit insurance from 1995 to 2000 -- before the Citigroup acquisition. CitiFinancial absorbed Associates First Capital into its lending operation after the takeover.

Although the F.T.C. settlement was the largest in the agency's history, CitiFinancial apparently did not completely overhaul its lending habits after that and continued to engage in other predatory practices that were uncovered by the Federal Reserve. The Fed said the abuses took place in 2000 and 2001 and were found during an examination related to Citigroup's acquisition of three other banks in 2001 and 2002.

Citigroup also announced yesterday that it planned to sell its 20 percent stake in a Saudi Arabian bank, the Samba Financial Group, ending its presence in the country after nearly 50 years.

Citigroup said it was selling the stake to a Saudi state entity, the Public Investment Fund, and would record an after-tax gain of $760 million when it released second-quarter earnings.

Over the last year, the Treasury Department and other federal agencies have pressed Saudi Arabia to scrutinize bank accounts there that are designated for relief aid to Palestinians. American authorities have said in interviews that some of the accounts might be conduits for terrorist financing.

The accounts in question are known in Saudi Arabia as Account 98 funds, the designation Saudi regulators use for money destined for Palestinian charities. Similar accounts exist for Saudi money intended for Muslims in other regions like Bosnia and Chechnya.

American officials have examined possible problems with Account 98 funds held at Samba. Leah Johnson, a Citigroup spokeswoman, declined to comment specifically about any communications it had with federal officials regarding the accounts when a reporter asked her about them last year.

''We are working with Samba in its ongoing effort to ensure that its antiterrorist procedures and controls are as effective as possible,'' Ms. Johnson said at the time. She declined to comment on the record about the matter yesterday.

A person at Citigroup briefed on the Samba sale said yesterday that it had nothing to do with concerns over terrorist financing problems in Saudi Arabia and that the deal was done for business reasons.