Bloomberg

Citigroup Saudi Deal Haunts Pandit

By Donal Griffin - Nov 30, 2011

Saudi businessman Ghazi Abbar, who claims in an affidavit he lost $383 million of his family's fortune on investments with Citigroup Inc., was sold one of the transactions even though the bank questioned his ability to properly manage them, according to an internal memo.

The memo, an exhibit in arbitration proceedings with the Financial Industry Regulatory Authority, warned that Abbar didn't have the risk-management capability of the large hedge funds that were typical clients of the bank's "hybrid" desk, which in 2006 was trying to persuade him to move his family's money into complex derivative securities.

Soured deals struck with wealthy clients are haunting Citigroup Chief Executive Officer Vikram Pandit. Finra awarded $54 million in April to customers of the New York-based bank's municipal-bond hedge funds, and in February, Brazilian investor Bernardo Valentini sued the bank, claiming he lost more than $24 million on derivatives Citigroup told him had "no risk of loss."

"The case is a setback in Pandit's vision of delivering financial services with a higher sense of responsibility to customers," said David Knutson, a credit analyst with Legal & General Investment Management in Chicago. "As each issue bubbles up, analysts or providers of capital to the firm have to say, 'OK, what other tape bombs are lying in the dusty lines of Citi's balance sheet?'"

Citigroup's Lawsuit

Citigroup denies Abbar's allegations, saying in a lawsuit that he was a sophisticated investor who knew the risks when he turned over control of his hedge-fund investments to the bank in exchange for derivatives that mimicked their performance. The bank has sued its former client in federal court in Manhattan to block the arbitration, arguing Finra has no jurisdiction because the deals were handled outside the U.S.

Danielle Romero-Apsilos, a Citigroup spokeswoman, declined to comment further.

According to the Finra claim, Citigroup had never before sold the investment idea to individual investors like Abbar, 56, whose family made its fortune in Saudi Arabia importing food and building businesses linked to tourism, aviation, cold storage, ship bunkering and oil. The hybrid team, which also arranged loans when clients wanted to leverage their bets, made about $200 million for the New York-based bank in 2007, people familiar with matter said.

Based in Jeddah, a port city on the Red Sea about 50 miles from Mecca, the Abbars were among the largest merchants in Saudi Arabia, with annual revenue of about $500 million, according to the internal memo. Family members had served in senior positions under the kingdom's late rulers, kings Faisal and Saud, according to the memo.

Pandit Meeting

Citigroup executives lined up to court Abbar, who oversaw the family's investments, according to the Finra complaint. Pandit, 54, met with Abbar after joining Citigroup in 2007 as part of the company's effort to maintain a relationship with the family. So did Chief Operating Officer John Havens, former wealth management boss Sallie Krawcheck and current global markets head Francisco "Paco" Ybarra, according to the complaint.

Abbar moved about $350 million of his family's wealth to Citigroup from Deutsche Bank AG (DBK) in 2006, and Citigroup rewarded the banker who persuaded Abbar to make the shift, Mohanned "Ned" Noor, with a trip to Hawaii, according to the claim. Abbar was introduced to the hybrid desk, which was growing under Pandit's predecessor, Charles "Chuck" Prince. Prince was trying to boost revenue by taking more trading risk.

Burns, Mathur

The hybrid group was run by Richard Burns, a London-based Citigroup veteran, according to two people familiar with the group who asked not to be named because they aren't authorized to speak about the matter. Burns oversaw structuring and trading of hybrid derivatives, securities whose values are tied to different kinds of underlying assets. Samir Mathur was head of hybrid trading for the group.

Abbar wanted a "simple loan structure" to finance some of the family's hedge-fund investments, he claims. Over meals in restaurants in London and New York, the hybrid team persuaded Abbar to instead transfer control of some of those assets to Citigroup, according to one of the people familiar with the matter. The desk then created the hybrid derivative that would mimic the performance of those funds.

Abbar claims he invested $383 million in the product and a separate private-equity financing deal, which included funds he injected after his initial transfer from Deutsche Bank. Both transactions collapsed after markets plunged in late 2008.

Tiger Management

Abbar had more experience with hedge funds than most. He began investing his family's fortune after he graduated with a master's degree in business administration from Harvard University in 1978. He built close relationships with hedge-fund managers such as Julian Robertson of Tiger Management LLC and joined the board of one of the Tiger funds in 1997, according to Fraser Seitel, a spokesman for

Tiger Management. Abbar said he also had relationships with Stephen Cohen, founder of SAC Capital Partners LP, billionaire Paul Tudor Jones and Louis Moore Bacon.

Still, as an individual, he was an unusual client for the desk, which typically dealt with large hedge funds and so-called fund of funds firms that make bets on other investment funds. Customers included Man Group Plc (EMG), the world's biggest hedge fund; Tudor Investment Corp., Tudor Jones's hedge fund; and Saudi Arabian financial-services firm Saad Group, according to the people familiar with the matter. Abbar didn't have those firms' resources, the bank said in the memo.

Operates 'Alone'

"The Client is not like the typical fund of funds client the desk is used to dealing with," according to the memo. "The Client does not maintain the extensive risk, due diligence and operational infrastructure that exists at most of the larger fund of funds. While Ghazi is experienced with alternative investments, he operates more or less alone with advice from his friends and industry contacts."

Abbar's lack of risk management concerned some Citigroup executives before he bought the product, according to one person familiar with the deal. Members of the hybrid desk concluded that his financial experience gave him the ability to manage the risks, and the bank approved the deal.

"Ghazi has the ability to understand the risks and rewards of the transactions," Citigroup wrote in the internal memo.

After the deal went through, members of the hybrid team were encouraged to sell similar products to other wealthy individuals, according to the person, who didn't want to be named because the matter is private.

Hedge Funds

Abbar's hedge-fund investment collapsed in 2008 as Lehman Brothers Holdings Inc. failed and funds around the world plunged. The Eurekahedge Hedge Fund Index dropped almost 12 percent in the second half of the year, Bloomberg data show. Many investors who used derivatives to multiply their bets were wiped out, according to Satyajit Das, author of "Extreme Money: Masters of the Universe and the Cult of Risk" (FT Press, 2011).

The leverage used to increase derivatives bets "is like playing Russian roulette with six bullets in the chamber," said Das, who isn't familiar with Abbar's case.

The failed investments erased the "considerable family wealth" the Abbars had placed with the bank and damaged relationships within the family, according to the claim. Citigroup now stands to gain $70 million as it sells off the hedge-fund assets at the center of the product, Abbar alleges.

'Nuclear' Products

"A lot of these highly leveraged, highly structured products, I analogize them to nuclear power," said John Lovi, an attorney with Steptoe & Johnson LLP who handles cases involving derivatives and isn't involved in the Abbar case. "There's no doubt that it's complicated and you better have your best and brightest on it and be watching it closely because when it goes bad, it goes really bad."

The collapse of the deal came as Citigroup itself was posting record losses caused by the financial crisis and its investments in collateralized debt obligations, another form of derivative. The bank lost a total of $29.3 billion in 2008 and 2009 and took a $45 billion taxpayer bailout. Senior executives allowed their hunt for more revenue to eclipse proper risk management, according to a 2008 Federal Reserve Bank of New York inspection report.

Pandit, who took the top job in December 2007, disbanded part of the hybrid team in 2008 and began to wind down the structuring side of the business, the people said. He has since begun an effort to convince investors that the bank's culture has changed to one of "responsible finance."

New Team

"We have a new management team, a new governance structure," Pandit said in a video on the bank's website, called new.citi.com. "We're completely focused around the client. Each and every one of our businesses is structured and always thinks about what is it that my clients need and how do I make sure I deliver all of Citi to each and every one of my clients."

Citigroup advanced $1.44, or 5.7 percent, to $26.68 at 10:46 a.m. in New York trading. The shares slid 47 percent this year through yesterday, compared with a 32 percent drop in the 24-company KBW Bank Index. (BKX)

Abbar is seeking $383 million. The largest award ever granted by Finra was $406.6 million for STMicroelectronics NV against Credit Suisse Group AG (CS) in 2009, according to Finra records.

Citigroup was on the wrong side of the largest award for individual investors in April, when Finra ruled in favor of a group of wealthy, Aspen, Colorado-based customers' $54 million claim, the records show. The clients said Citigroup misled them about the level of risk tied to investments in the bank's municipal-bond hedge funds.

'Guaranteed' Investment

In a suit brought in Manhattan federal court, Brazilian client Bernardo Valentini claims he lost more than $24 million on derivatives the bank told him were "guaranteed." He was convinced of the merits of the deal by two Citigroup private bankers, who visited his office in Curitiba and said they "wanted to get to know him," he said in the court filings. Citigroup denied the allegations.

Banks that sell complex derivatives to wealthy customers often face complaints when the deals don't work out as planned, said Das, the banker turned author.

"Clients are always good winners," Das said. "The moment they lose money, they suffer a 100-point drop in IQ."

Food Imports

Today, Abbar runs the largest of the family's businesses, Abbar Cold Stores, which imports frozen foods, fresh fruits and cheeses into Saudi Arabia, according to John Rich, an attorney in New York with Rich, Intelisano & Katz LLP, which represents the family.

Some of the executives mentioned in the case have since left Citigroup, including Ned Noor, the Geneva-based private banker who persuaded Abbar to move his money to the bank in the first place. He declined to comment on Abbar's claims.

Richard Burns and Samir Mathur continue to work in derivatives for Citigroup. They also declined to comment.

The Abbar case is Citigroup Global Markets Inc. v. Abbar, 11-CV-6993; the Valentini case is Valentini et al v. Citigroup Inc. (C) et al, 11-CV-01355. Both cases are in U.S. District Court, Southern District of New York (Manhattan).

To contact the reporters on this story: Donal Griffin in New York at Dgriffin10@bloomberg.net

To contact the editor responsible for this story: David Scheer at dscheer@bloomberg.net.