Robert Rubin on the job he never wanted

The reluctant chairman tells Fortune's Carol Loomis why Citi didn't see the subprime mess coming.

By Carol Loomis, Fortune senior editor at large

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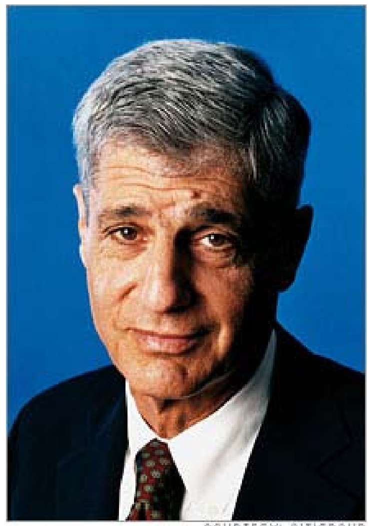
Rubin on his role: "I tried to help people as they thought their way through this."

When the new chairman of Citigroup, Robert Rubin, is asked why he was so tenacious and outspoken in supporting the chairman who just left, Charles "Chuck" Prince, Rubin delivers a typically introspective answer: "People are what they are, and that's what I am." Besides, he asserts, Prince deserved to stay: "He was doing what was right and what needed to be done."



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Citi's write-downs: What did it know, and when did it know it?

Rubin, 69, goes on to recall that he similarly supported Larry Summers in 2006 when the Harvard president was about to be forced out and that he also defended President Clinton in September 1998 during the bonfire days of the Monica Lewinsky affair. Just after prosecutor Kenneth Starr submitted his inflammatory report to Congress, Secretary of the Treasury Rubin declared on Tom Brokaw's NBC Nightly News that, regardless of the obvious problems, he believed Clinton to be doing "a very good job" as President.

An extreme irony in all this is that it is Rubin who could right now use a Rubinesque defender. On Sunday, Nov. 4, the same day Rubin reluctantly moved from the job of chairman of the executive committee to chairman of the board**, the company announced the startling news that it had $55 billion of collateralized debt obligations (CDOs) and other subprime-related securities on its balance sheet and that large write-offs of an estimated $8 billion to $11 billion were imminent**.

Within Citi, many employees - highly aware that Rubin was a risk wizard at both Goldman Sachs (Charts, Fortune 500) and the Treasury - are angry at what he didn't do to avoid both this disaster and earlier write-downs that Citi reported. Yes, the critics know Rubin has adamantly restricted himself to playing a nonoperating role at Citi, sticking mainly to advising the troops, from CEO on down, and dealing with important clients. Still, the burning question being asked today, outside Citi as well as in, is how all this CDO stuff could have gone on under his nose.

Although surely detesting the mere utterance of this question, Rubin contents himself with dismissing it. "The answer is very simple," he says. "It didn't go on under my nose." At Citi, as in any large company, he explains in a Business 101 way, you have people who are specifically responsible for certain areas - trading and risk, for example - and you have senior management making sure that they are highly qualified for the job and monitoring their work. And, Rubin says, "I am not senior management. I have this side role."

Okay, noted - except that this sideman of the dissonant Citi orchestra was paid $17.3 million last year. Rewards of that variety in other years have ordinarily left Rubin trailing only Prince and his predecessor, Sandy Weill, in compensation. That sure leaves Rubin looking a lot like senior management. In addition, what more important assignment could a consigliere to the CEO have than trying to anticipate risks? Both Prince and Weill, in fact, have talked in the past about the value of their conversations with Rubin, though Prince isn't available to be queried about that matter now.

A larger part of Rubin's explanation as to why Citi (Charts, Fortune 500) failed to avert its CDO train wreck concerns the sheer difficulty of heading it off. True, worries about a "housing bubble" abounded. Rubin himself gave countless speeches in recent years that talked about investors, in all manner of asset classes, "underweighting" risk - that is, sloughing off its importance. But he wasn't on the trading floors where the mortgage-related decisions had to be made, and he knows from deep experience that's where the buck stops.

Only the rare investor, Rubin points out, was able to anticipate the collapse. As an illustration, he refers to the **New York private equity and hedge fund community**, which he knows well. In the first six months of this year, he says, there may have been a few people in this club who positioned themselves to profit when things went bad. He measures them as no more than "a handful." Ditto the people who successfully hedged their positions, thereby offsetting some of the trouble in July and August. That would be another handful, he thinks.

Rubin doesn't need the reminder, but this writer injects it into the conversation anyway, remarking that the handful included **Goldman Sachs, which this year has made large profits by shorting mortgage-related securities.** Rubin acknowledges the fact quietly: "Some people did."

Goldman appears also to have scored by hedging long positions early this year. At a **Citi analyst call** on Nov. 5, just after the impending write-downs had been announced, Citi CFO Gary Crittenden said the company did some hedging in the first part of the year too**. But by July and August, when the need for protection was terrifyingly apparent, the ability to hedge, especially in the large amounts that Citi needed, was virtually nonexistent. Citi had by that time, starting in July, organized daily meetings in which Rubin participated. He says, "I tried to help people as they thought their way through this. Myself, at that point, I had no familiarity at all with CDOs."**

At bottom, the countdown to both Prince's exit and Citi's November shocks began in that summer crisis period for the credit markets. Citi started then to have ominous dealings with CDOs that carried a "**liquidity put**." Never heard of a liquidity put? Google will give you a few uninformative references. But it is testimony to the obscurity of this term that Rubin says he had never heard of liquidity puts until they started harassing Citi last summer.

What Citi did a couple of years ago was insert a put type of option into otherwise conventional CDOs that were backed by subprime mortgages and sold to such entities as funds set up by Wall Street firms. **The put allowed any buyer of these CDOs who ran into financing problems to sell them back - at original value - to Citi**. The likelihood of the put being exercised, however, was regarded as extremely remote because the CDOs were structured to be high-grade entities called "super-senior."

Prince Alwaleed: Why Chuck had to go

Meanwhile, **you might think the existence of the put would make it impossible for Citi to get those CDOs entirely off its balance sheet. But in fact Citi found a complex accounting rationale for doing exactly that, and the CDOs jumped entirely to somebody else's balance sheet. All that remained in Citi's realm was this sticky little matter of the puts - which, as we shall immediately see, ultimately worked to get these CDOs right back to their creator, Citi**.

Last summer, with the whole world suddenly unwilling to finance CDOs, the holders of the liquidity-put CDOs began to return them to Citi. And that's where they now reside - $25 billion of them, a very large lump in Citi's $55 billion of subprime-related securities. That entire package of trouble was the subject of Citi's Nov. 5 analyst call. This was the third presentation that Citi had made to analysts in five weeks - each of these confessionals more anguished than the last - and in that time Citi's stock and Prince's credibility had been punished.

But remarkably, Nov. 5 was the first time that Citi mentioned liquidity puts to the world. CFO Crittenden says the need to make disclosures about the puts did not arise until the last part of October, because until then the super-senior status of the put-laden securities made it appear they would largely hold their value. But that didn't take into account the rating agencies, which suddenly went on a downgrade binge. Their **rating changes made it clear that Citi's super-seniors would have to be written down**.

Crittenden and his staff met late on Thursday, Oct. 25, to begin sizing up the damage. Crittenden left the meeting not yet certain about the numbers. But he knew enough to tell Prince on Friday that the news would be very bad. With that, the beleaguered Prince recognized that his credit line of goodwill was used up. On the weekend, he called Rubin to say that he thought the only "honorable" action for him to take was to resign. Rubin urged Prince to stay, an expression of continuing support implying that Rubin, as a Citi director - an influential one - was prepared, despite the fresh onset of bad news, to keep backing Prince at the board level. Prince nonetheless remained determined to exit.

Rubin says unequivocally that Prince's resignation "was a Chuck-made decision." A modified view, though, is suggested by *Fortune*'s interview with Prince Alwaleed bin Talal bin Abdul Aziz al Saud (see the full text), who with a nearly 4% ownership, is Citi's biggest single shareholder. Alwaleed stayed supportive of Prince right through Citi's second earnings call, on Oct. 15.

But when word began to leak in late October that Citi would report huge new write-offs, Alwaleed was outraged and called Prince to tell him he would "withdraw" his support. That didn't necessarily mean curtains for Prince. Citi's board could conceivably have stuck with him. But it is easy to imagine that the prospect of a fight with Alwaleed was one big negative on Prince's mind as he proceeded to resign.

From that weekend when Rubin and Prince talked, it took another week of board and internal meetings for the financial news to be released and for the management scheme that included a foot-dragging Rubin to be crafted. He has been joined at the top by the head of Citigroup Europe, Sir Winfried Bischoff, 66, who will be interim CEO until the board finds a permanent boss.

Rubin has by these events been plunged into a job he wished above all to avoid: the top post in a major financial company in a period of crisis. But having made the wrenching decision to disturb what he calls "the arc of my life," Rubin seems bent on dragging this monster company out of the ditch. He says, "This is an important institution - not just to a lot of people, but also to the economy, globally. I think that this institution needs what Win Bischoff and I can bring to it." He pauses slightly: "And that's where my head is at the moment."

Raffles Place CDO (collateralized debt obligation)

Issuer: Raffles Place Funding, Ltd (Cayman Islands)

Co-issuer: Raffles Place Funding Corp (Delaware)

Collateral Manager: UOB Asset Management (Singapore)

Sole active book runner (main underwriter) and lead manager: Citigroup

Trustee, collateral administrator, issuing and paying agent: LaSalle Bank

Put counterparty: Citibank NA

Hedge counterparty: Citigroup Financial Products, Inc. (guarantor Citigroup Inc).