

BEFORE THE NATIONAL ADJUDICATORY COUNCIL  
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Continued Membership  
of  
Citigroup Global Markets Inc.  
with  
FINRA

Notice Pursuant to  
Rule 19h-1  
Securities Exchange Act  
of 1934

SD-2048

Date: September 8, 2016

**I. Introduction**

On October 8, 2014, Citigroup Global Markets Inc. (“CGMI” or the “Firm”) submitted a Membership Continuance Application (“MC-400A” or the “Application”) to FINRA’s Department of Registration and Disclosure. The Application seeks to permit the Firm, a FINRA member subject to a statutory disqualification, to continue its membership in FINRA. A hearing was not held in this matter. Rather, pursuant to FINRA Rule 9523(a), FINRA’s Department of Member Regulation (“Member Regulation”) recommended that the Chair of the Statutory Disqualification Committee, acting on behalf of the National Adjudicatory Council, approve the Firm’s continued membership in FINRA pursuant to the terms and conditions set forth below.

For the reasons explained below, we approve the Firm’s Application.

**II. The Statutorily Disqualifying Event**

CGMI is subject to a statutory disqualification, as that term is defined in Section 3(a)(39) of the Securities Exchange Act of 1934 (the “Exchange Act”), as a result of a Final Judgment (the “Judgment”) entered on August 5, 2014, by the United States District Court for the Southern District of New York.<sup>1</sup> The Judgment permanently enjoined the Firm from violating Sections 17(a)(2) and (3) of the Securities Act of 1933 (the “Securities Act”) in the offer or sale of any security or security-based swap agreement.

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<sup>1</sup> Exchange Act Section 3(a)(39), which incorporates by reference Exchange Act Section 15(b)(4)(C), provides that a person is subject to statutory disqualification if it is enjoined from, among other things, engaging in any conduct or practice as a broker-dealer or in connection with the purchase or sale of any security.

The Judgment resulted from a complaint filed by the SEC that alleged CGMI made materially misleading statements in marketing materials it prepared for a synthetic collateralized debt obligation (“CDO”) called Class V III, which it structured and marketed in 2007. Specifically, the SEC alleged that CGMI’s marketing materials suggested that CGMI was acting in a traditional role of an arranging bank (i.e., the bank that structures and markets the transaction). CGMI, however, exercised significant influence over the selection of assets in the CDO and also established a short position by entering into credit default swaps (“CDS”) on assets it helped select for the CDO. CGMI retained an approximately \$500 million short position in the assets, which represented half of the Class V III investment portfolio. The short position gave CGMI an undisclosed economic interest adverse to those of the investors in Class V III. CGMI collected approximately \$34 million in fees for structuring and marketing the CDO, and sold \$343 million of Class V III equity and mezzanine notes to approximately fourteen institutional investors (all of which received the marketing materials prepared by CGMI). Those marketing materials failed to disclose CGMI’s influence over the selection of the assets in the CDO and CGMI’s short position. By early November 2007, approximately 83 percent of the CDOs in the Class V III investment were severely downgraded by rating agencies and by mid-November 2007, Class V III declared an event of default. Investors in Class VI III lost several hundred million dollars, yet CGMI, along with other of the Firm’s affiliates, realized net profits of at least \$160 million. By engaging in this conduct, the SEC alleged that CGMI violated Securities Act Sections 17(a)(2) and 17(a)(3).

On August 5, 2014, without admitting or denying the allegations in the SEC’s complaint, CGMI consented to the entry of the Judgment.<sup>2</sup> In addition to enjoining CGMI, the Judgment ordered the Firm to pay \$160,000,000 in disgorgement, together with prejudgment interest of \$30,000,000 and a civil penalty of \$95,000,000.<sup>3</sup> The Judgment also requires CGMI to comply with the following undertakings:

- A. Product Review and Approval: The role of the relevant Capital Markets Approval Committee or Commitment Committee (the “Responsible Committees”) (or any other committee performing the function currently performed by either of the Responsible Committees) will be expanded to include all initial offerings of residential mortgage-related securities (other than agency real estate mortgage-backed securities (“RMBS”)), including collateralized debt obligations referencing or including such securities (collectively “mortgage securities”) in which CGMI is the lead underwriter,

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<sup>2</sup> The SEC and CGMI engaged in settlement negotiations for approximately three years. The parties initially attempted to settle the matter for \$285 million, but the U.S. District Court for the Southern District of New York rejected the settlement. On appeal, the U.S. Court of Appeals for the Second Circuit vacated the lower court’s decision and remanded the case for further consideration, and the U.S. District Court ultimately entered the Judgment approving the settlement on August 5, 2014.

<sup>3</sup> CGMI paid the amounts described as of August 21, 2014.

placement agent, or plays a similar role (“mortgage securities offerings”). The Responsible Committee shall ensure that processes are in place so that written marketing materials for such mortgage securities do not include any material misstatements or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

- B. Role of Internal Legal and Compliance: For all mortgage securities offerings, Representatives of CGMI’s Legal or Compliance Department will review: (i) all written marketing materials used by CGMI in connection with mortgage securities offerings (i.e., term sheets, investor presentations or “pitch books,” and other non-prospectus marketing materials); (ii) all offering circulars/prospectuses used by CGMI in connection with mortgage securities offerings, where CGMI does not retain outside counsel to review such materials; and (iii) any written submissions to either of the Responsible Committees (or any other committee performing the function currently performed by either of the Responsible Committees) regarding any such mortgage securities offering. CGMI will establish a procedure for recording the occurrence of such review, including the name of the Legal Department employee or Compliance Department employee who conducted the review, the date of the review and the particular materials that were reviewed.
- C. Role of Outside Counsel: For all mortgage securities offerings where CGMI retains outside counsel to advise on the offering, such outside counsel will be asked to review all written marketing materials and offering circulars/prospectuses used in connection with the offering. To assist in this review, such outside counsel will be provided with documents sufficient to reflect all material terms of the transaction.
- D. Internal Audit: CGMI will conduct an internal audit review, on at least an annual basis, to determine that items (A), (B), and (C) are being complied with. Any deficiencies noted by internal audit shall be promptly addressed by CGMI.
- E. Certification of Compliance by Defendant: The General Counsel or Global Head of Compliance of CGMI shall certify annually (one year, two years, and three years, respectively, after the date of entry of the Judgment) in writing, compliance in all material respects with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. SEC staff may make reasonable requests for further evidence of compliance, and Defendant agrees to provide such evidence. The certification and any such additional materials shall be

submitted to the Chief of the Structured and New Products Unit, with a copy to the Office of Chief Counsel of the Enforcement Division.<sup>4</sup>

### **III. Background Information about CGMI**

CGMI has been a member of FINRA since 1936. The Firm is based in New York City. According to FINRA's Central Registration Depository ("CRD"®), it has 675 branch offices, including 115 of which are Offices of Supervisory Jurisdiction ("OSJs"). The Firm employs over 7,000 registered individuals and 14,789 non-registered individuals. CGMI employs one person, Michael C. Furman, who is statutorily disqualified. Furman works out of the Firm's New York, New York office at 390 Greenwich Street.

#### **A. Recent Routine Examinations**

The Firm's 2015 cycle examination is still in progress. The Firm underwent a cycle examination in 2014 that concluded in June 2015. The 2014 examination resulted in a referral to FINRA's Department of Enforcement for exceptions relating to risk management controls for brokers or dealers with market access. FINRA also issued the Firm a Cautionary Action for a number of other exceptions identified in the 2014 examination, including failure to comply with FINRA's margin and supervisory requirements, the SEC's financial responsibility rules (Exchange Act Rules 15c3-1 and 15c3-3), books and records rules (Exchange Act Rules 17a-3 and 17a-4), prospectus delivery requirements, and other FINRA and SRO rules.

The 2013 cycle examination of the Firm concluded in April 2014. The 2013 examination resulted in a Cautionary Action against the Firm for exceptions relating to the Firm's failure to comply with the SEC's financial responsibility rules and books and records rules.

#### **B. Recent Regulatory Actions**

In the past two years, CGMI has been subject to regulatory actions by FINRA, federal regulators, state securities commissions and other SROs.

During that time, the Firm executed 13 Letters of Acceptance, Waiver and Consent ("AWCs") in connection with FINRA investigations. None of the violations addressed by these AWCs involve or relate to the misconduct that led to the Firm's statutory disqualification. In summary, these AWCs addressed rule violations involving trade reporting, best execution, FINRA's research rule, and failure to supervise, among others. Pursuant to these AWCs, CGMI was censured and ordered to pay a range of fines (from \$18,500 to \$15 million) and, in certain cases, ordered to comply with certain undertakings.

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<sup>4</sup> CGMI filed its first certification with the SEC in August 2015.

In addition to the Judgment that resulted in the Firm's statutory disqualification, in 2015, CGMI was also subject to three separate SEC orders in administrative proceedings. A June 18, 2015 SEC order found that the Firm willfully violated Securities Act Section 17(a)(2) for due diligence failures in connection with municipal securities offerings for which CGMI acted as either a senior or sole underwriter. The Firm was ordered to cease and desist from committing or causing further violations, fined \$500,000, and ordered to comply with various undertakings.<sup>5</sup>

In another SEC order dated August 17, 2015, the SEC found that the Firm willfully violated Sections 17(a)(2) and (3) of the Securities Act and Section 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act"), due to material misstatements and omissions made by CGMI in its offer and sale of securities in two now-defunct hedge funds managed by Citigroup Alternative Investments LLC.<sup>6</sup> The SEC ordered the Firm to cease and desist from committing or causing future violations and pay disgorgement in the amount of \$139,950,239 and prejudgment interest of \$39,612,089.

The third SEC order, dated August 19, 2015, found that the Firm willfully violated Section 15(g) of the Exchange Act and Section 206(4) of the Advisers Act, as well as Rule 206(4) thereunder due to long-term technology problems that caused the Firm to inadequately monitor trading activity.<sup>7</sup> The Firm was ordered to cease and desist from causing or committing future violations, pay a fine of \$15 million, and comply with certain undertakings.<sup>8</sup>

In 2015, CGMI also participated in a global settlement reached with a multistate task force composed of members of the North American Securities Administrators Association ("NASAA"). The settlement related to the activities of sales assistants in various states and territories and the supervision of those sales assistants' registration status during the period of January 2007 through September 2014. As part of the settlement, CGMI agreed to pay each state or territory that entered into a consent order \$35,000 in fines and investigatory costs. To date, the Firm has settled with 34 state or territory securities commissions. CGMI has also entered into agreements with state

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<sup>5</sup> FINRA filed a Rule 19h-1 Notice on August 10, 2015, approving CGMI's continued membership notwithstanding the statutory disqualification that resulted from the June 18, 2015 order. The Commission acknowledged FINRA's notice on August 20, 2015.

<sup>6</sup> While this finding renders the Firm statutorily disqualified, no application was required since the fine was paid to the SEC and no further sanctions were ordered.

<sup>7</sup> The Firm filed an MC-400A application in connection with its statutory disqualification that resulted from this proceeding. That application is under review.

<sup>8</sup> CRD also indicates that in July 2016, CGMI submitted an offer of settlement in connection with an SEC administrative action, which stemmed from allegations that the Firm failed to furnish the SEC with true and complete trade data in response to its requests. The Firm consented to a cease-and-desist order and a \$7 million fine.

securities commissions for other alleged violations that are not relevant to this Application.

Finally, CGMI has settled several disciplinary actions by other SROs or exchanges. In the last two years, the Firm settled four SRO actions that included fines of \$100,000 or more. In April 2016, the Firm executed an AWC with The NASDAQ Stock Market LLC for failing to properly identify orders as short sale orders. In August 2015, the Firm executed an AWC with The New York Stock Exchange LLC (“NYSE”) for improperly effecting transactions for its own account without qualifying for an exception. The Firm also executed an AWC in December 2014 with NYSE for failing to deliver prospectuses in connection with its sales of certain Exchange Traded Funds from 2009 through April 2011. Finally, in November 2014, the Firm settled an action with the Chicago Board of Trade for failing to timely report certain interest rate futures following execution.

#### **IV. The Firm’s Proposed Continued Membership in FINRA and Proposed Supervisory Plan**

CGMI seeks to continue its membership in FINRA notwithstanding the Judgment that triggered its statutory disqualification. As noted above, the SEC required CGMI to comply with five undertakings that relate to any business it conducts involving RMBS (other than agency RMBS), including CDOs. CGMI has implemented the changes required by the SEC and has already completed its first annual certification. In connection with the Application, CGMI proposed the following plan of supervision (the “Supervisory Plan”):

1. Comply with the undertakings specified in the Judgment;
2. Establish protocols to ensure that the undertakings outlined in the Judgment are completed in the time period established in the Judgment or by the time period granted by SEC staff in any extension;
3. Provide FINRA with copies of correspondence between the Firm and SEC staff regarding any requests to extend the procedural dates relating to the undertakings; and
4. Provide FINRA with a copy of each certification required and all supporting documentation that will be provided to the SEC upon completion of the undertakings or as requested by the SEC as specified in the Judgment. These documents must be sent directly to:

Lorraine Lee-Stepney  
Manager, Statutory Disqualification Program  
FINRA  
1735 K Street NW

Washington, DC 20006  
Lorraine.Lee@finra.org

Subsequent to an approval of the Firm's continued membership in FINRA notwithstanding its statutory disqualification, FINRA will utilize its examination and surveillance processes to monitor the Firm's compliance with the standards prescribed by FINRA Rule 9523. Specifically, FINRA will examine the Firm during either the first year following the filing of the Rule 19h-1 Notice or, alternatively, during the Firm's regularly scheduled cycle examination, to ensure that the Supervisory Plan is implemented and that the Firm is complying with its requirements. Subsequent to that initial examination, the determination of whether to subject the Supervisory Plan to further review will be driven by FINRA's overall risk-based assessment of the Firm.

## **V. Discussion**

Member Regulation recommends approving CGMI's request to continue its membership in FINRA. After carefully reviewing the entire record in this matter, we approve the Application.

In evaluating an application like this, we assess whether the statutorily disqualified firm seeking to continue its membership in FINRA has demonstrated that its continued membership is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors. *See* FINRA By-Laws, Art. III, Sec. (3)(d); *cf. Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (holding that FINRA "may deny an application by a firm for association with a statutorily-disqualified individual if it determines that employment under the proposed plan would not be consistent with the public interest and the protection of investors"). Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, and whether there has been any intervening misconduct.

Although the Judgment involved serious violations of the federal securities laws, the violative conduct occurred in 2007, close to nine years ago, and related to a single CDO offering. Further, the Judgment required, and CGMI has implemented, undertakings related to the Firm's mortgage securities business. CGMI is required to certify to the SEC on an annual basis that it is complying with the required undertakings and, pursuant to the Supervisory Plan, it will forward copies of such certifications to FINRA. CGMI also represents that it has independently enhanced its processes specific to its U.S. Securitization Markets business. The Firm represents that its enhancements cover businesses involving the Firm's U.S. Mortgage Trading Desk, Mortgage Analytics Group, Mortgage Finance Group, Mortgage Sales Desk, Commercial Mortgage Finance Group, Consumer Finance Group, and Strategic Trading Desk. We further find that

beyond the undertakings described above, the Judgment did not impose an expulsion or suspension of CGMI, or otherwise limit its securities activities.<sup>9</sup>

We further find that although CGMI has recent regulatory history, the record shows that it has taken corrective actions to address noted deficiencies. We agree with Member Regulation that CGMI's regulatory history should not prevent it from continuing as a FINRA member, and based upon CGMI's representations and compliance with the Judgment's undertakings and the Supervisory Plan, we conclude that its continued membership is in the public interest and does not present an unreasonable risk of harm to the market or investors.

At this time, we are satisfied, based in part upon the Firm's representations, Member Regulation's representations concerning FINRA's future monitoring of the Firm, and the record currently before us, that the Firm's continued membership in FINRA is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors. Accordingly, we approve CGMI's Application to continue its membership in FINRA as set forth herein.<sup>10</sup> In conformity with the provisions of Exchange Act Rule 19h-1, the continued membership of the Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith  
Senior Vice President and Corporate Secretary

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<sup>9</sup> We further note that, in connection with the Judgment, the SEC found good cause to grant the Firm a waiver from the disqualification provision of Securities Act Rule 506(d)(1)(ii).

<sup>10</sup> FINRA certifies that CGMI meets all qualification requirements and represents that it is registered with the NSX and NYSE ARCA, as well as BATS, CBOE, CHX, EDGA Exchange, Inc., ISE, NYSE, NYSE MKT LLC, NASDAQ OMX PHLX, NASDAQ OMX BX, NASDAQ Stock Market, DTC, NSCC, and FICC, which concur with the Firm's proposed continued membership.