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FINANCIAL INDUSTRY REGULATORY AUTHORITY

2009 FEB 18

LETTER OF ACCEPTANCE, WAIVER AND CONSENT

NO. 20050018527-01

REGISTRATION & DISCLOSURE

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NASD REGULATION, INC.
MARKET REGULATION

TO: Department of Market Regulation
Financial Industry Regulatory Authority ("FINRA")

RE: Citigroup Global Markets Inc., Respondent
Broker-Dealer
CRD No. 7059

Pursuant to NASD Rule 9216 of FINRA Code of Procedure, Citigroup Global Markets Inc. (the "firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

The firm has been a member of FINRA, formerly known as NASD, since October 16, 1936, and its registration remains in effect.

RELEVANT PRIOR DISCIPLINARY HISTORY

- On June 12, 2007, FINRA accepted an AWC, which censured and fined the firm \$87,000 for violations of NASD Rules 2110, IM-2110-2, 3010, 3340, 3370 and 6130, and SEC Rules 15c2-11, 200(g) and 604.

20050018527 (includes 20050032509, 20050026288,
20050030932, 20060050661, 20060058098,
20060056743 and 20060059737)
(TSG)

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- On January 16, 2007, FINRA accepted an AWC which censured and fined the firm \$42,500 for violations of NASD Rules 2110, 2320, 3010, 6420, 6620 and 6955, and SEC Rule 10b-10.
- On June 28, 2005, FINRA accepted an AWC, which censured and fined the firm \$60,000 for violations of MSRB Rules G-14 and G-27.
- On January 28, 2005, FINRA accepted an AWC, which censured and fined the firm \$107,500 for violations of NASD Rules 2110, 2320, 3350, 3360, 4642 and 6130, and SEC Rule 604.

SUMMARY

The staff of FINRA's Department of Market Regulation (the "staff") has conducted investigations of the firm in the following areas: Order Audit Trail System ("OATS") compliance, order handling, fixed income transaction reporting, the publication of bona fide quotations and transactions, and related supervision.¹

FACTS AND VIOLATIVE CONDUCT

OATS

1. Between August 1, 1999 and July 10, 2006, the firm failed to report to OATS Reportable Order Events ("ROEs") for approximately 6.4 million orders on approximately 1,745 business days. Each order resulted in one or more ROEs. The conduct described in this paragraph constitutes violations of NASD Rules 2110 and 6955(a).
2. During the period between August 1, 1999 and July 10, 2006, the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to the applicable securities laws and regulations, and the Rules of NASD, concerning OATS reporting. Specifically, the firm failed to establish supervisory procedures that were reasonably designed to ensure that the firm's systems and trading desks were submitting all reportable orders to OATS. The conduct described in this paragraph constitutes a violation of NASD Rules 2110 and 3010.
3. In December 2005, the firm incorrectly reported its capacity on 778 Execution Reports submitted to OATS. The conduct described in this paragraph constitutes violations of NASD Rule 6955(a).

¹ Attached as Exhibit A is a description of the scope of each investigation.

4. During the period July 1, 2005 through September 30, 2005, the firm failed to submit to OATS Execution or Cancellation Reports on 42 customer limit orders. The conduct described in this paragraph constitutes violations of NASD Rule 6955(a).

Limit Order Display

5. On 69 occasions during the period of July 1, 2005 through September 30, 2005, the firm failed to display immediately 69 customer limit orders in Nasdaq securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each such security, and the size of the order represented more than a *de minimis* change in relation to the size associated with the firm's bid or offer in each such security. The conduct described in this paragraph constitutes violations of SEC Rule 604.
6. During the period July 1, 2005 through September 30, 2005, the firm failed to report to OATS the Limit Order Display indicator for 33 OATS reportable orders, and failed to submit a cancellation report for one OATS reportable order. The conduct described in this paragraph constitutes violations of NASD Rule 6955(a).

Fixed Income Reporting

7. During the period July 1, 2002 through September 30, 2006 (the "review period"), the firm failed to report to TRACE the correct capacity for 265,185 transactions in TRACE-eligible securities. The conduct described in this paragraph constitutes violations of NASD Rule 6230(c)(7).
8. During the review period, the firm failed to report to TRACE 60,669 transactions in TRACE-eligible securities that it was required to report. The conduct described in this paragraph constitutes violations of NASD Rules 2110 and 6230(b).
9. During the review period, the firm reported to TRACE 1,340 transactions in TRACE-eligible securities that it was not required to report. The conduct described in this paragraph constitutes violations of NASD Rule 6230(e).
10. During the review period, the firm failed to report to TRACE the correct yield for 2,240 transactions in TRACE-eligible securities. The conduct described in this paragraph constitutes violations of NASD Rule 6230(c)(13).
11. During the review period, the firm failed to report the correct capacity in 200,417 reports of transactions in municipal securities. The conduct described in this paragraph constitutes violations of MSRB Rule G-14(b)(ii).
12. During the review period, the firm failed to report 280,332 purchase and sale transactions effected in municipal securities. The conduct described in this paragraph constitutes violations of MSRB Rule G-14.

13. During the review period, in 1,773 instances, the firm improperly reported information that it should not have. The conduct described in this paragraph constitutes violations of MSRB Rule G-14.
14. During the review period, the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to the applicable securities laws and regulations, and the Rules of NASD, concerning fixed income transaction reporting. Specifically, the firm failed to establish supervisory procedures that were reasonably designed to ensure that the Firm's systems and trading desks were submitting timely, accurate and complete reports of transactions in fixed income securities. The conduct described in this paragraph constitutes a violation of NASD Rules 2110 and 3010, and MSRB Rule G-27.
15. During the period January 1, 2006 through March 31, 2006, the firm failed to report to TRACE 7,826 transactions in TRACE-eligible securities within 15 minutes of the time of execution. The conduct described in this paragraph constitutes violations of NASD Rules 2110 and 6230(a).
16. During the period January 1, 2006 through March 31, 2006, the firm failed to report to TRACE the correct contra party identifier for 23 transactions in TRACE-eligible securities. The conduct described in this paragraph constitutes violations of NASD Rule 6230(c)(6).
17. During the period January 1, 2006 through March 31, 2006, the firm failed to report to TRACE 21 transactions in TRACE-eligible securities that it was required to report. The conduct described in this paragraph constitutes violations of NASD Rule 6230(b).

Quadruple Expiration Day

18. On June 17, 2005, a Quadruple Expiration Day in the marketplace, a day on which contracts for stock index futures, stock index options, stock options and single stock futures all could expire, the firm experienced a data outage before 8:00 am on its U.S. Equities Desk. The data outage caused the firm's quotations to reflect a zero or null value in thousands of securities. Subsequent to this event, it was determined that the data outage was attributable to a server that had been in place for several years but which was not on the firm's inventory list and therefore had not received routine maintenance or hardware inspection.
19. The firm was not able to resolve the data outage and, by 8:50 am, it began the process of re-directing, with a technology tool, the market data from its primary servers to its secondary or backup servers. The technology tool, which had not been tested in 2005 prior to this event, failed to re-direct the servers as intended, and the firm began to re-direct the servers manually.

20. The manual re-direction of the servers was not completed by 9:25 am, which was the market open time for the purposes of the firm's system's quotation availability and automated execution functionality. At that time, a software program failed due to a coding error, which had never been subject to testing or inspection. Consequently, the firm's Auto Trade application failed to detect a zero or null value in the firm's quotations, which was designed to prohibit decrementing and/or incrementing the price to create a market maker quotation, resulting in thousands of non-bona fide quotations.
21. As a result of the technology failures described above, the firm published thousands of non-bona fide quotations that were not related to the market value of the subject securities, which resulted in executions of approximately 6,800 non-bona fide transactions executed at prices up to 98% away from the June 16, 2005 closing price in each security. The firm ultimately petitioned Nasdaq to cancel approximately 6,800 trades in 174 securities, which petition was granted, thereby reducing the firm's loss from approximately \$6.7 million to \$250,000. The firm's erroneous quotations also impacted the Nasdaq BBO, triggering executions by other firms that were at prices unrelated to the market value of the securities, resulting in those firms also petitioning Nasdaq to cancel approximately 1,492 trades.
22. The conduct described in paragraphs 18 through 21 constitutes violations of NASD Rules 2110 and 3310.
23. The firm's quotations began to normalize around 9:28:40, with quotation normalization concluding at approximately 9:46:55. The firm then filed a series of Clearly Erroneous Petitions, initially seeking cancellation of certain trades that were executed between 9:20 am and 9:32 am. The petitions were submitted without sufficient review by the firm's supervisory personnel. The conduct described in this paragraph constitutes a violation of NASD Rules 2110 and 3010.
24. The firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to the applicable securities laws and regulations, and the Rules of NASD for handling Clearly Erroneous Petitions pursuant to NASD Rule 11890. Specifically, the firm's supervisory system did not include written supervisory procedures providing for: (1) the identification of the person(s) responsible for supervision with respect to the applicable rules; (2) a statement of the supervisory step(s) to be taken by the identified person(s); (3) a statement as to how often such person(s) should take such step(s); and (4) a statement as to how the completion of the step(s) included in the written supervisory procedures should be documented. The conduct described in this paragraph constitutes a violation of NASD Rules 2110 and 3010.
25. During the investigation of this matter, FINRA requested copies of certain correspondence relating to the firm's securities business that the firm is required to retain. The retained records were not made readily available to FINRA upon request. The conduct described in this paragraph constitutes a violation of NASD Rules 2110 and 3010(d)(3).

OTHER FACTORS

The firm notified the staff in September 2005 that certain orders were not being reported to OATS, and supplemented that notification as it discovered certain additional OATS problems. The firm also hired an independent consultant to conduct a review of the firm's OATS reporting processes, and in July 2007 presented the independent consultant's findings to the staff. Similarly, in October 2005, the firm notified the staff that it had failed to report or had misreported certain fixed income transactions. The firm reported or corrected the large majority of the previous trade reports. The sanctions set forth below take into consideration the fact that the firm self-reported its OATS and trade reporting violations and took prompt and thorough remedial steps to address those problems.

B. The firm also consents to the imposition of the following sanctions:

A censure and a fine of \$2,000,000 (comprised of a \$325,000 fine for the OATS violations, a \$50,000 fine for the Limit Order Display violations, a \$625,000 fine for the fixed income transaction reporting violations and a \$1,000,000 fine for violations stemming from the events of June 17, 2005, which include violations of NASD Rules 2110, 3010 and 3310), and an undertaking to revise the firm's written supervisory procedures with respect to the areas described in paragraphs two, 14 and 24. Within 45 business days of acceptance of this AWC by the NAC, a registered principal of the Respondent shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed, dated letter, providing the following information: (1) a reference to this matter; (2) a representation that the firm has revised its written supervisory procedures to address the deficiencies described in these paragraphs; and, (3) the date the revised procedures were implemented. The firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

The firm specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Formal Complaint issued specifying the allegations against the firm;

- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the firm specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The firm understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the firm; and
- C. If accepted:
 - 1. this AWC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the firm's disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-3; and
 4. The firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The firm certifies that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the firm to submit it.

12-5-08

Date

Citigroup Global Markets Inc.

By: Elaine H. Mandelbaum

Name: Elaine H. Mandelbaum

Title: Managing Director & Deputy
General Counsel

Reviewed by:

Harry J. Winer

Counsel for Respondent

Accepted by FINRA:

3/12/09

Date

Signed on behalf of the
Director of ODA, by delegated authority

Thomas R. Gira
Thomas R. Gira
Executive Vice President
Department of Market Regulation

EXHIBIT A

Order Audit Trail System Compliance

1. In connection with 20050026288, the firm self reported to FINRA that it failed to report to OATS Reportable Order Events for approximately 6.4 million orders on 1,745 business days.
2. In connection with 20060050661, the staff conducted an Exception Code review for December 2005.
3. In connection with 20060058089, the staff conducted a review of the firm's compliance with Limit Order Protection requirements during the period July 2005 through September 2005. The review did not identify LOP violations, but did uncover OATS violations.

Order Handling

4. In connection with 20050030932, the staff conducted a review of the firm's compliance with Limit Order Display requirements during the period July 2005 through September 2005.

Fixed Income Transaction Reporting

5. In connection with 20050032509, the firm self reported to FINRA that it failed to report or inaccurately reported over 500,000 fixed income transactions during the period July 1, 2002 through December 23, 2005.
6. In connection with 20060056743, the staff conducted a review of the firm's reporting of inter-dealer transactions to TRACE during the period January 2006 through March 2006.
7. In connection with 20060059737, the staff conducted a review of the firm's compliance with NASD Rule 6230(a) during the period January 2006 through March 2006.

Quadruple Expiration Day

8. In connection with 20050018527, the staff conducted a review of the firm's quotation and trading activity on June 17, 2005, and Clearly Erroneous petitions filed by the firm in connection with certain executions on that day between approximately 9:25 am and 9:46 am.