

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070094201**

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

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

Pursuant to FINRA Rule 9216 of the FINRA Code of Procedure, Citigroup Global Markets, Inc. (the "Firm" or "Citigroup") 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 is a wholly-owned subsidiary of Citigroup Financial Products, Inc. and indirectly a wholly-owned subsidiary of Citigroup, Inc. The Firm's principal place of business is in New York, New York. The Firm is, and was during the relevant period, a member firm of FINRA or a predecessor entity. The Firm provides services including investment banking, underwriting debt and equity securities and advising corporations, governments and institutions, as well as acting as a full-service global broker-dealer. The Firm trades securities for institutional and individual customers as well as for proprietary accounts.

RELEVANT DISCIPLINARY HISTORY

The Firm has previously been disciplined on a number of occasions for violations of Rules pertaining to supervisory procedures, including the following:

- In March 2009, pursuant to Letter of Acceptance, Waiver and Consent No. 20050018527, the Firm consented to a \$2 million fine, based on FINRA's findings that over an approximately seven-year period the Firm had supervisory

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failures related to certain reporting and limit order display rules, had violated those underlying rules, and had system failures that led the Firm to erroneously publish non-bona fide quotations and transactions on a trading day.

- In New York Stock Exchange Hearing Board Decision 07-121, the Firm consented to findings that it violated the NYSE supervisory rule because it failed to establish and maintain appropriate procedures for supervision and control of short interest reporting. The Firm also consented to findings that it submitted inaccurate reports of short positions, and to a censure and a \$300,000 fine.
- In 2007, in Letter of Acceptance, Waiver and Consent No. 2005000760101, the Firm consented to findings that it and certain managers failed to adequately supervise the activities of brokers, who had persuaded retirees to replace their pensions and 401(k) accounts with privately managed investment accounts. The Firm consented to a \$3,000,000 fine, and \$12,200,000 in restitution for affected customers.

OVERVIEW

The Firm's New York-based Equity Finance Desk ("Equity Finance Desk" or "the Desk") violated Firm guidelines and FINRA Rules in connection with implementing two trading strategies, each of which used equity swaps and was designed to generate a perceived tax advantage related to dividend income. One of these trading strategies, the "U.S. Equity Trades," involved U.S. equities, and the Firm's Equity Finance Desk engaged in the U.S. Equity Trades from approximately 2002 through the spring of 2005. A principal reason the Firm and its clients structured certain of the U.S. Equity Trades in the manner that they did was to enable these foreign investor clients, who were the Firm's counterparties on these trades, to realize the full value, free of withholding taxes, of dividends payable on actual U.S. equities. However, in certain of the U.S. Equity Trades, the Firm entered into improper transactions, in that the Firm purchased equities from clients/counterparties, in particular, foreign broker-dealers, with the understanding that, upon termination of the particular trade, the equities would be directly or indirectly resold to the same customer, so that the parties would re-establish their original equity positions.

The other trading strategy that is the subject of this AWC was proprietary and involved Italian equities. The Firm engaged in the "Italian Equity Trades" from approximately 2000 until 2004. The Firm structured the Italian Equity Trades in an effort to become eligible for refunds of certain non-U.S. taxes relating to the dividends on these equities. In these trades, the Firm's New York Equity Finance Desk failed to maintain its independence in the conduct of certain stock transactions which also involved two other Firm affiliates, Salomon International Financial Products LLC ("Citi-Swiss") and Citigroup Global Markets Limited ("Citi-London"). In certain of these transactions, Citi-London directed the Equity Finance Desk with respect to, among other things, the number of shares to trade and the interdealer broker to use in their execution.

In connection with the above-described activities, the Firm failed reasonably to supervise and control certain activities of the Equity Finance Desk by failing to: (1) establish

procedures reasonably designed to detect and prevent improper trades between the Firm and certain counterparties, and between Firm entities; (2) monitor certain trading activities conducted by the Desk; and (3) ensure compliance with reporting requirements.

FACTS AND VIOLATIVE CONDUCT

Failure to Supervise

NASD Rule 3010 requires member firms to establish and maintain a system, including written procedures, to supervise the activities of its employees, which is reasonably designed to achieve compliance with applicable securities laws and regulations. As shown below, with respect to both the U.S. Equity Trades and the Italian Equity Trades, the Firm failed to supervise the activities of the Equity Finance Desk and failed to establish, maintain, and enforce written supervisory procedures regarding these trades. The Firm thereby violated NASD Rule 3010 and NASD Rule 2110.

History of the Equity Finance Desk

The Equity Finance Desk's typical business involves the execution of equity swaps, stock loans, and stock purchases and sales, in a multitude of jurisdictions, for both clients and the Firm's own accounts. The Equity Finance Desk has pursued numerous trading strategies, including the types of transactions at issue in this case, as well as other types of transactions that were not tax-related.

The U.S. Equity Trades

The Firm and its counterparties to the U.S. Equity Trades understood that dividends on American equities held by foreign investors were subject to U.S. withholding tax, but that an amount equivalent to that dividend could, in certain circumstances, be provided to the foreign investor without being subject to such withholding tax. The U.S. Equity Trades were structured so that the Firm's foreign investor clients would receive the full value of dividends of American securities, free of applicable U.S. withholding tax.

To initiate a U.S. Equity Trade, the Equity Finance Desk in New York purchased a security or basket of securities from a foreign investor in advance of the relevant dividend dates. This purchased security would then be held by the Firm, acting as custodian for the Firm's United Kingdom-based affiliate entity, Citi-London. Citi-London's just-purchased stock would be the underlying equity hedge in a "total return swap" that Citi-London would near-simultaneously enter into with that same counterparty.

Under the total return swap, Citi-London made payments to the counterparty based on the income the stock generated. The "total return" was any income the securities generated, including any appreciation in value as well as an amount equivalent to any dividends. Thus, Citi-London paid dividend equivalent amounts to the counterparty. At that time, the Firm's Equity Finance Desk used such terms as "dividend uplift," "dividend enhancement," and "yield enhancement," to describe the amount that would have been withheld in taxes on the dividend, but which was provided to the counterparty under the

swap. In exchange for the "total return" payments, which included the full value of the dividend, free of withholding tax, the client/counterparty made periodic interest payments to Citi-London, and also agreed to pay for any depreciation of the underlying stock.

Some time after the dividend date, the swap would be terminated, generally at the request of the counterparty. To complete the transaction, the Equity Finance Desk in New York would sell the stock on behalf of Citi-London.

The U.S. Equity Trades that are the subject of this AWC occurred from approximately 2002 through 2005, with the most significant activity occurring in 2004 and early 2005. The Firm did not promulgate written internal guidelines specific to the U.S. Equity Trades until December 2003. At that point, in conjunction with the Firm's Tax Department, the New York-based Equity Finance Desk developed guidelines ("the Guidelines") in an effort to ensure that the transactions between the Firm and its counterparties would be viewed as independent marketplace transactions for tax purposes and that the tax benefits associated with this trading strategy could be realized. Accordingly, the Guidelines required, inter alia, that: the Equity Finance Desk must anticipate selling the stock originally bought from the customer "into the market"; the swap agreement must be open for at least 45 days; and, with regard to the closing transaction, the number of shares underlying the swap must not exceed certain volume limitations.

The Guidelines did not go into effect until on or after April 2004, and Firm traders understood that the Guidelines could be verbally modified by the Firm's Tax Department in appropriate circumstances, even after that date. Moreover, after the Guidelines were implemented, Desk personnel conducted improper transactions that also deviated from the Guidelines.

A significant number of the U.S. Equity Trades put on by the Desk were based on the understanding that the stock the client sold to the Firm would be delivered back to the client at the termination of the associated swap. Notwithstanding the Guidelines, Firm personnel on the Equity Finance Desk used various methods to fulfill this understanding. These methods included: (1) making direct trades with the clients/counterparties through off-exchange transactions or Third Market Transactions; (2) selling the stock to an interdealer broker with the understanding or knowledge that the counterparty would go to the same interdealer broker to purchase the stock; (3) exchanging Bloomberg messages with the counterparties as the swap was being unwound to facilitate the counterparties' repurchase of the underlying securities; and (4) using large volume market-on-close orders, when only a limited number of buyers, including the counterparty, would be ready to accept such an order.

In spring 2005, an internal audit disclosed the Equity Finance Desk's use of the above-described methods. Overall, the audit determined that certain of the U.S. Equity Trades were conducted in a manner that was not in compliance with the Tax Department Guidelines.

The audit also disclosed that there was no formal monitoring procedure in place for the U.S. Equity Trades.

Following the audit, the Firm engaged an outside law firm to review Firm practices and policies. The Firm subsequently implemented changes, including changes of personnel, changes to procedures, and the initiation of a monitoring process. In September 2005, the Firm self-reported to regulators the findings of the auditors and outside counsel.

During and prior to 2006, the Firm made payments aggregating approximately \$24 million to the Internal Revenue Service in connection with the U.S. Equity Trades, after determining that there was a risk that the Firm could not substantiate the independence of at least some of these transactions, sufficient to distinguish them from stock loans or stock repurchase agreements, and that the dividend equivalent amounts relating to these transactions would therefore be subject to U.S. withholding tax.

The Italian Equity Trades

The Firm also engaged in the Italian Equity Trades, in a manner generally designed to enhance after-tax yields received by Citi-London on Italian equity securities without incurring market price exposure on those securities. Pertinent to this matter, the Firm developed a strategy that was comprised of a series of transactions by its New York-based Equity Finance Desk, as well as Citi-London and Citi-Swiss, and in certain instances with or through unrelated stock lending counterparties and interdealer brokers. In large part, the transactions were designed to provide Citi-London with tax-related benefits that were not available to the Firm by holding stock over a dividend period. The strategy was carried out as described below.

In the Italian Equity Trades, Citi-London directed the Firm's Equity Finance Desk in New York to borrow securities issued by Italian companies that were expected to declare dividends. The Desk loaned these securities to Citi-Swiss, which then sold the same securities back to the Equity Finance Desk. The Desk then sold the securities to an interdealer broker, who, in turn, sold the securities to Citi-London. Citi-London and Citi-Swiss then entered into a swap to cover the risk each had acquired as a result of being long and short, respectively, in this transaction. After the dividend date, the transaction was unwound in the reverse order.

Citi-London held the Italian Equity securities until after the dividend date in order to generate favorable treatment from the Italian tax authorities for itself, and in anticipation of generating such additional tax benefits for the Firm. Pursuant to the tax treaty between the United Kingdom and Italy, Citi-London, as a U.K. citizen, believed it would be entitled to seek a refund of a portion of the Italian income taxes attributed to dividends. Citigroup, Inc., as a corporate entity, would benefit because Citi-London, through the refunds, would receive additional income from the Italian Equity Trades. If the strategy were successful, the corporate entity would profit, because the benefits of Citi-London's

long position, which included any tax benefit, would be greater than the costs associated with acquiring the position and the attendant costs of the hedging.

Throughout the Italian Equity Trades, the Firm improperly coordinated with Citi-London in the planning and execution of these Trades, with Citi-London providing and the Firm accepting direction in varying degrees regarding when to trade, the number of shares to trade, and/or the interdealer broker to use in a given transaction. Further, Desk personnel effected both sides of supporting trades on behalf of both the Firm and Citi-Swiss.

The Italian Equity Trades took place from approximately 2000 through approximately 2004, with the most significant activity in 2003. The Firm failed to establish written supervisory procedures specific to these trades.

In April 2003, the Firm obtained an opinion letter written by Italian tax counsel that offered guidance on these trades, and set forth a process that was intended to qualify Citi-London to claim the tax benefit under the treaty. The Firm, however, did not follow this process, which had contemplated that the trades would not be subject to any understanding between and/or among Firm entities. Both before and after the date of that letter Firm entities, the Desk, Citi-Swiss and Citi-London, coordinated the planning and execution of these trades, as described above.

The Firm's gross revenue from the Italian Equity Trades described above exceeded \$7 million, which the Firm obtained in refunds from the Italian government. In the course of settling an investigation into these trades by that government, the Firm agreed to seek no additional refunds from the Italian Equity Trades. The Firm had originally anticipated seeking a substantially larger amount of refunds from the above-described Italian Equity Trades.

Lack of Monitoring of Bloomberg Messages

Pursuant to NASD Rule 3010, the Firm was required to review communications between its staff and outside parties. Since at least March 2004, the Equity Finance Desk and the counterparties used Bloomberg messages to communicate on the U.S. Equity Trades. At that time, the Firm had an automated review process for emails, but Bloomberg messages were not included in that system. The Firm phased in the inclusion of Bloomberg messages into that review. The Firm did not incorporate into its review the Bloomberg communications sent to and from the Equity Finance Desk until the first quarter of 2005. Had a monitoring system been in place earlier, the Firm might have discovered that certain Firm traders and counterparties used Bloomberg messages to coordinate with respect to the repurchase of securities.

Summary

As described above, the Firm failed to adequately supervise the activities of the Desk, and did not timely prevent or detect the improper coordination between the Firm and

counterparties in both the U.S. Equity and the Italian Equity Trades, provide for effective written procedures with respect to the implementation of these trades, and monitor Bloomberg messages. As a result of the supervisory failure, the Firm violated NASD Rule 3010 and NASD Rule 2110.

Failure to Report Trades

During the relevant time, NASD Rule 6420 required firms to transmit to Nasdaq reports of transactions in "eligible securities executed . . . otherwise than on a national securities exchange." Eligible securities were defined in NASD Rule 6410 as, inter alia, stocks listed on a national or regional stock exchange. Similarly, during the relevant time, NASD Rule 6620 required firms to transmit to Nasdaq reports of transactions in over the counter securities. At least some of the transactions involving securities in the U.S. Equity and Italian Equity Trades were not reported to an exchange, as they were required to be, pursuant to the aforementioned Rules. In particular, the Firm should have reported the securities purchases and sales effected by the Equity Finance Desk. This conduct by the Firm violated NASD Rules 6420 and 6620, as well as NASD Rule 2110. Moreover, the Firm failed to establish and maintain appropriate procedures for supervision and control for its Equity Finance Desk, including a system of follow-up and review, with respect to the reporting of certain transactions. As such, the Firm violated NASD Rules 3010 and 2110.

OTHER FACTORS

In determining the appropriate sanction in this matter, FINRA took into account that the Firm discovered and self-reported the violations giving rise to this AWC. In addition, the Firm hired a law firm to conduct a review of these matters and to assist in remedial efforts. Further, the Firm and its outside counsel provided substantial assistance to FINRA staff during the investigation.

B. Citigroup also consents to the imposition of the following sanctions:

1. A censure, and
2. A fine in the amount of \$600,000.

The Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. The Firm has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The Firm specifically and voluntarily waives any right to claim it is unable to pay, nor or at any time hereafter, the monetary sanction 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 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 FINRA Rule 9143 or the separation of functions prohibitions of FINRA 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 FINRA 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 FINRA Rule 8313; 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 undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm 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.

7/10/09
Date

Citigroup Global Markets, Inc.

By: Edward Tuvan

Name: Edward Tuvan.

Title: Senior Deputy General Counsel / MD

Reviewed by:

David Brodsky
David Brodsky
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Accepted by FINRA:

July 28, 2009
Date

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

Susan Light
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