

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011026502901**

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

RE: Citigroup Global Markets Inc., Respondent
(CRD No. 7059)

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Citigroup Global Markets Inc. ("Citigroup" or 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 Citigroup alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Citigroup 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

Citigroup is a global investment banking and multi-service brokerage firm that provides services that include investment banking, underwriting debt and equity securities and advising corporations, governments and institutions as well as acting as a full-service broker-dealer. It is registered with the Securities and Exchange Commission ("SEC") as a broker-dealer and investment adviser and has been a FINRA registered firm since October 16, 1936.

RELEVANT DISCIPLINARY HISTORY

In September 2007, in connection with New York Stock Exchange Hearing Board Decision 07-143, Citigroup entered into a Stipulation of Facts and Consent to Penalty and consented to a sanction consisting of a \$2,250,000 fine, an undertaking (the "Undertaking"), and a censure for violating Rule 10b-10 of the Securities Exchange Act of 1934 and New York Stock Exchange ("NYSE") Rules 401(a), 1100(b) and 342. From July 2003 through October 2004, the Firm failed to have appropriate policies and procedures relating to the delivery of offering

documents to customers who purchased particular securities. This failure resulted in numerous systemic deficiencies in the delivery of offering documents to customers. In particular, the Firm failed to deliver product descriptions or any other disclosure document, such as a prospectus, to certain customers who purchased Exchange Traded Funds ("ETFs").

OVERVIEW

Citigroup failed to deliver prospectuses in connection with sales of certain ETFs to customers from 2009 through April 2011 (the Relevant Period). Between September 2010 and November 2010 alone, the Firm failed to deliver prospectuses for approximately 255,000 customer purchases of approximately 160 ETFs. As a result, Citigroup acted in contravention of Section 5(b)(2) of the Securities Act of 1933 (the "Securities Act") and thereby violated FINRA Rule 2010. As discussed above, the Firm was previously sanctioned by the NYSE in 2007 for failure to deliver ETF prospectuses. Citigroup self-reported the ETF prospectus delivery failure to FINRA in January 2011.

In addition, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010 by failing to design and implement an adequate supervisory system to achieve compliance with the securities law and regulations governing ETF prospectus delivery. The Firm also violated NASD Rule 3012 and FINRA Rule 2010 by failing to establish, maintain and enforce supervisory control policies and procedures that tested and verified that its ETF prospectus delivery procedures were in compliance with applicable securities laws and regulations and FINRA rules.

FACTS AND VIOLATIVE CONDUCT

Citigroup's Prior Undertaking and Certification

As described above, in 2007 Citigroup entered into a Stipulation of Facts and Consent to Penalty consenting to a finding that the Firm failed to deliver product descriptions (or any other disclosure document, such as a prospectus) to certain customers who purchased ETFs, and failed to have appropriate policies and procedures relating to its delivery of offering documents, such as product descriptions and prospectuses, to customers who purchased certain securities. The NYSE Hearing Officer imposed the agreed-upon penalty of a censure, a fine of \$2,250,000 and an Undertaking. The Undertaking required the Firm to provide NYSE with a written certification that the Firm's policies and procedures regarding the delivery of prospectuses, product descriptions, and trade confirmations were reasonably designed to ensure compliance with the applicable federal securities laws and NYSE rules. The Firm was required to submit such certification within 90 days from the date on which the decision became final.

On December 31, 2007, the Firm timely submitted, through its then head of Capital Markets Private Clients Operations, a certification ("Certification") that "the Company's current policies and procedures, including written supervisory and operational policies and procedures regarding the delivery of prospectuses and product descriptions are reasonably designed to ensure compliance with the federal securities laws and NYSE rules applicable to the delivery of prospectuses and product descriptions."

However, during the Relevant Period, the Firm's supervisory systems concerning ETF prospectus delivery were not adequate to ensure compliance with prospectus delivery requirements. As a result, it experienced significant failures to deliver certain ETF prospectuses.

Citigroup Failed to Deliver Prospectuses to ETF Customers and thus Violated FINRA Rule 2010

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.¹ Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market. Under Section 5(b)(2) of the Securities Act of 1933, delivery of ETFs is prohibited unless it is accompanied or preceded by a copy of a prospectus, or a written description if certain conditions are met.

During the Relevant Period, Citigroup failed to deliver certain ETF prospectuses to customers. This violation occurred because the Firm's supervisory system was not reasonably designed to ensure ongoing compliance with the prospectus delivery rules, as discussed further below. The Firm failed to deliver ETF prospectuses for approximately 255,000 customer purchases of approximately 160 ETFs during September to November 2010, the three-month period for which Citigroup self-reported the ETF prospectus delivery failure. Consequently, from 2009 through April 2011, it is estimated that Citigroup may have failed to deliver prospectuses for over one and a half million purchases of ETFs by its customers.

Based on the foregoing, Citigroup acted in contravention of Section 5(b)(2) of the Securities Act and thereby violated FINRA Rule 2010.

¹ See FINRA Regulatory Notice 09-31, *Non-Traditional ETFs* (June 2009) ("Reg. Notice 09-31").

The Firm Failed to Reasonably Supervise ETF Prospectus Delivery, In Violation of NASD Rule 3010 and FINRA Rule 2010

NASD Rule 3010(a) (in effect during the Relevant Period and to November 30, 2014) requires FINRA member firms to establish and maintain a system to supervise its employees that is reasonably designed to achieve compliance with the federal securities laws and FINRA and NASD Rules.

FINRA Rule 2010 requires that all members, in the conduct of business, shall observe high standards of commercial honor and just and equitable principles of trade.

First, the Firm's supervisory system concerning ETF prospectus delivery was not reasonably designed to achieve compliance with prospectus delivery requirements during the Relevant Period. In order to ensure that it sent the required ETF prospectuses to customers, the Firm relied on its employees to manually review the websites of three different stock markets to identify newly-listed ETFs. When staff identified a new ETF in the market, they entered a code into the Firm's automated system to trigger prospectus delivery whenever that ETF was sold. This manual process resulted in both procedural errors and human errors.

Although the Firm procedures during the Relevant Period required that "each month, the [Syndicate] Operations Manager, or his designee, will review a sample of trade confirms for trades in an ETF security issued during the previous month to verify that the confirms are appropriately legended for prospectus delivery" and document such review, it did not require supervisors to perform adequate quality checks to identify new ETFs that had not been detected during the Firm's manual review, and the supervisors did not perform such checks. While it was reasonably foreseeable that the manual process could result in human errors, the Firm's supervisory system did not provide a sufficient process through which the Firm could detect and prevent these errors. As a result, the Firm experienced significant failures to deliver certain ETF prospectuses during the Relevant Period. Accordingly, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010.

In addition, the Firm maintained a decentralized supervisory system that was not reasonably designed to ensure compliance with its prospectus delivery requirements during the Relevant Period. On December 31, 2007, the Firm's head of Capital Markets Private Clients Operations certified to the NYSE that the Firm's then-current policies and procedures regarding the delivery of prospectuses and product descriptions, among other things, were reasonably designed to ensure compliance. That individual departed from the Firm in April 2008. Thereafter, supervisory responsibility for ETF prospectus delivery was not clearly defined. Although the Firm was aware of its previous ETF prospectus delivery problems resulting in a significant regulatory action, and despite the Firm's reliance on a wholly manual process to code ETFs for prospectus delivery, the Firm relied upon decentralized supervision of this activity until it designated a

senior manager with overall supervisory responsibility in late 2010 and converted to an automated system for coding ETFs for prospectus delivery in approximately April 2011. The Firm's decentralized supervisory structure governing ETF prospectus delivery was not reasonably designed to achieve compliance with the securities laws. This contributed to the Firm's failure to identify deficiencies in its process, to timely identify the scope of the problem after the Firm detected certain failures in 2009, and to timely remedy the inadequacies in its manual process. Thus, from about 2009 to April 2011, the Firm maintained a supervisory structure that was inadequate to address its ETF prospectus delivery problems that resurfaced after the NYSE Certification.

The 2007 NYSE disciplinary action, with its accompanying Undertaking, put the Firm on notice that ETF prospectus delivery was an area that required further supervisory diligence. However, despite its execution of the Undertaking, in which it certified that its procedures in this area (and others) were reasonably designed to comply with applicable laws and rules, the Firm did not appropriately respond to red flags indicating that it had experienced failures to deliver. Although Citigroup noted isolated ETF prospectus delivery failures in 2009, it did not determine the extent of the issue or fully recognize deficiencies in its supervision in these areas until 2010. In January 2011, Citigroup self-reported the ETF prospectus delivery failures to FINRA.

Based on the foregoing, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010.

The Firm Failed to Have Supervisory Controls in Place to Ensure Prospectus Delivery for ETF Purchases in Violation of NASD Rule 3012 and FINRA Rule 2010

NASD Rule 3012 (in effect during the Relevant Period and to November 30, 2014) requires FINRA-registered firms to establish, maintain and enforce a system of supervisory control policies and procedures. Firm principals are responsible for both testing the firm's current supervisory procedures to ensure they are reasonable for the business being conducted, and creating additional procedures where gaps in the procedures exist. The designated principals must submit to the firm's senior management, no less than annually, a report detailing its system of supervisory controls, the summary of the test results and the identified exceptions, and any additional or amended supervisory procedures created in response to the test results.

The Firm failed to satisfy its NASD Rule 3012 obligations by failing to adequately test its supervisory procedures for ETF prospectus delivery, or prepare NASD Rule 3012 reports that were adequate to address ETF prospectus delivery testing and verification in 2009 and 2010.

NASD Rule 3012(a)(1)(B) requires the Firm to test and verify that its supervisory procedures are reasonably designed to achieve compliance with applicable securities laws and regulations. Testing to determine whether ETF transactions were coded to generate prospectus delivery was handled by various groups within the Firm. Internal Audit, Operations Control (with the assistance of Market Risk and Control) and Compliance all conducted testing and verification of these procedures at certain times during the Relevant Period. Each of these departments tested based on limited samples of trades. Such small samples, generally consisting of one to ten trades, were inadequate to ensure reasonable testing and verification of the Firm's relevant procedures. In addition, although the Internal Audit department conducted testing, the Internal Audit Program Director who oversaw the audits was not aware of the 2007 NYSE disciplinary action and the resulting Undertaking. Internal Audit did not assign an appropriate level of risk to the Firm's ETF prospectus delivery activities, contributing to the inadequacy of its testing during audits in the Relevant Period. Internal testing was particularly important, in light of the Firm's prior experience with systemic failures to deliver ETF prospectuses and its Certification in 2007 that its then current procedures were reasonably designed to comply with applicable legal requirements.

In addition, the Firm's Rule 3012 reports failed to adequately address ETF prospectus delivery testing and verification. The Firm's 2009 Annual Compliance Report (required by NASD Rule 3012), dated April 1, 2010, did not refer to any tests of ETF prospectus delivery, despite the recent NYSE finding. The Firm's 2010 Annual Compliance Report, dated April 1, 2011, noted the ETF prospectus delivery failures that are the subject of this Enforcement action but failed to identify any additional or amended supervisory procedures created in response to the test results.

The Firm's approach to testing and verification and its related controls were not reasonable in light of the Firm's knowledge of its previous failures in the area of ETF prospectus delivery.

Based on the foregoing, the Firm violated NASD Rule 3012 and FINRA Rule 2010 by failing to establish, maintain and enforce a system of supervisory controls to verify that its ETF prospectus delivery procedures were reasonably designed to comply with the applicable laws, rules and regulations during the Relevant Period.

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

- 1. Censure; and**
- 2. Fine in the total amount of \$3,000,000. (Paid jointly to FINRA and NYSE)**

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

Citigroup has specifically and voluntarily waived any right to claim an inability to pay 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

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

- A. To have a 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, Citigroup specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, 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.

Citigroup 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

Citigroup 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 accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. Citigroup 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 my: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Citigroup may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Citigroup 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.

12/9/2014
Date (mm/dd/yyyy)

Reviewed by:

By: Joshua E. Levine
Managing Director

Reviewed by:

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Accepted by FINRA:

12/11/14
Date

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


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