

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2012032923301**

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," "Respondent" 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 the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent 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 Global Markets, Inc., a FINRA-registered broker dealer since 1936, has its principal place of business in New York, New York. Citigroup is a full service firm providing investment banking, asset management, brokerage, securities trading, and advisory services. The Firm trades securities for institutional and individual customers as well as for proprietary accounts.

RELEVANT DISCIPLINARY HISTORY

Citigroup consented to various findings including that, from July through September 2007, it failed to establish and maintain written policies and procedures concerning independent price verification for pricing collateralized debt obligation securities and documenting its price verification process and failed to demonstrate that it had not used stale prices for hand-priced subprime securities in certain of its business activities in violation of SEC Rules 17a-3(a)(8) and 17a-4 and NASD Rules 3010 and 2010. The Firm consented to a sanction of a censure and a \$3.5 million fine. *See Matter No. 2008012808101* (AWC May 2012).

OVERVIEW

From 2009 through at least June 2012, the Firm failed to establish and maintain supervisory systems, procedures and written supervisory procedures (“WSPs”) reasonably designed to ensure that it accurately calculated the value of the securities it held. The Firm’s supervision was inadequate in several ways. The Firm did not have adequate procedures to ensure that it verified its pricing in a consistent manner. The Firm used different methods to value the same securities for different purposes, and had no system or procedure to compare these valuations and identify or investigate discrepancies.

In addition, from December 2010 through July 2011, the Firm’s system for applying required deductions to the value of certain of its mortgage-backed securities (“MBS”) positions when computing the Firm’s net capital was inadequate. The system was not reasonably designed because it did not update required deductions after they had been manually adjusted and the Firm lacked an adequate process to monitor, review or otherwise supervise manual adjustments. As a result, the Firm overstated its net capital during this period in amounts as high as \$26 million. In addition, since in or about 1998 through June 2012, the Firm failed to have adequate systems and procedures in place to ensure that its stock record accurately reflected bond loan transactions and related repurchase agreements.

By the foregoing, the Firm violated NASD Rules 3010(a) and (b), Section 15c of the Exchange Act of 1934 (“Exchange Act”) and Rule 15c3-1(c)(2)(vii) thereunder, Section 17a of the Exchange Act and Rules 17a-3 thereunder, and FINRA rules 4511 and 2010.

FACTS AND VIOLATIVE CONDUCT

Inadequate Supervision of Pricing and Valuation

NASD Rule 3010(a) required FINRA members to establish and maintain a supervisory system, including written procedures, to supervise each type of business in which they engage.¹ The system and procedures must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD Rules.

NASD Rule 3010(b) required each member to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws, regulations, and rules.

FINRA Rule 2010 required members to “observe high standards of commercial honor and just and equitable principles of trade.” A violation of NASD Rule 3010 also constitutes a violation of FINRA Rule 2010.

¹ NASD Rule 3010 was superseded by FINRA Rule 3110 effective December 1, 2014.

From at least 2009 through at least mid-2012, the Firm lacked systems, procedures and WSPs to ensure that it priced securities accurately throughout the Firm.

From 2009 through at least June 2012, a Firm trader would estimate the value of a security that did not have an easily-identifiable market price. In order to verify the accuracy of these prices, the Firm's Product Control Group ("PCG") compared the trader's marks to prices that the PCG derived from market data. The Firm collected this market data from a variety of sources, including the Firm's market making desks, vendor prices, exchange prices and other internal pricing data. However, the Firm's WSPs failed to set forth how the PCG should use this information to conduct its reviews. For example, the Firm's WSPs failed to specify: (i) which sources the PCG should rely on as principal sources, and which should be considered secondary; (ii) what types of alternative pricing methods the PCG should use for certain product types; and (iii) what thresholds the PCG should use to determine if a trader's mark was so different from the PCG's determination that it was likely inaccurate. The Firm also lacked systems, procedures and WSPs to monitor the quality of the data it received from outside vendors.

Different departments within the Firm separately priced the same securities using the same market data, but applied the data in different ways, resulting in the same hard-to-value securities being priced differently for different purposes. For example, on January 31, 2011, the margin department used one method to price certain MBS for purposes of calculating margin requirements while the PCG used a different method to separately price the same securities for regulatory reporting purposes. The two different pricing methodologies resulted in prices for four MBS on January 31, 2011 that varied between \$4.91 to \$11.06 per CUSIP, resulting in total position values that differed by as much as \$1 million.

The Firm lacked systems and procedures to ensure that the pricing differences were identified and reasonable under the circumstances. Although the Firm had a report that identified instances when a single security was assigned multiple prices within its inventory, that report was generated only on a monthly basis, did not capture customer securities, and was distributed only to the PCG. The Firm did not use the report to identify and review discrepancies in prices used for collateral and margin purposes.

By failing to implement a reasonable system or procedure to supervise its price verification and ensure accurate valuations of securities, the Firm violated NASD Rule 3010(a) and (b) and FINRA Rule 2010.

Inaccurate Haircuts Resulting in Inaccurate Net Capital Computations

Exchange Act Rule 15c3-1 requires a broker-dealer to maintain a minimum amount of net capital and to compute its net capital in accordance with specified formulas. A violation of Exchange Act Rule 15c3-1 also constitutes a violation of FINRA Rule 2010.

To compute its net capital, a broker-dealer must determine the value of the securities it owns and then deduct a specified percentage of the value of each of those securities. Under Exchange Act Rule 15c3-1(c)(2)(vii), if a broker-dealer owns securities for which there is no ready market or that cannot be publicly offered or sold without registration, it must deduct (or "haircut"²) 100% of their value from its calculations. On July 13, 2001, the Securities and Exchange Commission issued a No-Action Letter that set forth the circumstances when a broker-dealer must deduct 100% of the value of its MBS, and when it could apply a haircut of less than 100% to investment grade MBS.

Hard Coding Failures of the Firm's Haircut System

The Firm used a system known as its FOCUS Haircut System ("Haircut System") to automatically apply haircuts to its MBS positions in order to calculate its net capital. The Haircut System determined the status of each MBS based on various data feeds and then applied the required haircut. The system allowed Firm personnel to manually override haircuts ("hard code") applied by the system. For example, if Firm personnel determined that the Haircut System had incorrectly categorized an investment grade MBS as a non-investment grade MBS, they could manually change the security's status (and, thus, its haircut) in the Haircut System. Once an MBS was manually hard coded by Firm personnel, the Haircut System continued to apply the hard coded haircut indefinitely, without any automated notification or reset.

As result, the Firm applied incorrect haircuts to certain MBS that fell to non-investment grade status after being hard coded based on their prior status as investment grade MBS. For example, in July 2011 the Firm incorrectly applied haircuts between 9% and 15% to three MBS positions that required a 100% haircut. This caused the Firm to overstate its net capital by approximately \$26 million dollars. Similarly, between December 2010 and July 2011, on 12 other occasions, the Firm overstated its net capital by up to \$14.8 million because it applied incorrect haircuts to certain MBS positions.

During this period, the Firm lacked adequate supervisory systems and WSPs for monitoring and reviewing manual overrides in the Haircut System. The Firm did not require supervisory review of manual overrides before they were made or track such overrides after they had been made to ensure that the hard coded status of those securities continued to be correct.

The Firm did require manual review of haircuts applied to all non-government securities with a market value of \$10 million or more, including the haircuts resulting from manual overrides. However, it assigned responsibility for this manual review to the same individual who supervised the initial haircut process. This represented a compounding control weakness in the supervision of haircut-related processes.

² A haircut is the percentage by which the value of certain firm assets are reduced in the course of completing its net capital calculations pursuant to Exchange Act Rule 15c3-1(c)(2)(vii) and various other guidance from the Securities & Exchange Commission.

Based on the foregoing, the Firm violated Section 15c of the Exchange Act and Rule 15c3-1(c)(2)(vii) thereunder and FINRA rules 3010 (a) and (b) and 2010.

Inaccurate Net Capital Computations and FOCUS Reports

NASD Rule 3110, in effect until December 4, 2011, and FINRA Rule 4511, in effect since December 5, 2011, require members to make and preserve books, accounts, records, memoranda, and correspondence in conformity with applicable NASD, FINRA and Exchange Act rules. Under Section 17a of the Exchange Act and Rule 17a-3(a)(11) thereunder, broker-dealers are required to make and keep current accurate books and records, including, but not limited to, a record of the computation of aggregate indebtedness and net capital pursuant to Rule 15c3-1.

From December 2010 through July 2011, the Firm maintained inaccurate books and records. Specifically, its books and records reflected the inaccurate net capital computations caused by the application of incorrect haircuts to its MBS positions as described above.

Based on the foregoing, the Firm violated Section 17a of the Exchange Act and Rules 17a-3(a)(11) thereunder, NASD Rule 3110 and FINRA Rule 2010.

Inaccurate Stock Record

Section 17a of the Exchange Act and Rule 17a-5 thereunder further require member firms to make and keep current a "securities record or ledger reflecting separately for each security as of the clearance dates all 'long' or 'short' positions (including securities in safekeeping and securities that are the subjects of repurchase or reverse repurchase agreements) carried by such member, broker or dealer for its account or for the account of its customers or partners . . . and showing the location of all securities long and the offsetting position to all securities short"

Since in or about 1998 through June 2012, the Firm posted bond loan transactions and related repurchase agreements to the same Firm account. After the positions were netted together, the stock record incorrectly reflected the Firm's inventory in these positions. During this period the Firm also failed to have in place systems and procedures to ensure the accuracy of its stock record. By the foregoing, the Firm violated Section 17(a) of the Exchange Act and Rule 17a-3(a)(5) thereunder, NASD rules 3110, 3010(a) and (b) and FINRA Rules 4511 and 2010.

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

- 1) A censure; and
- 2) A fine in the amount of \$850,000.

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

Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now 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

Respondent specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- 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, Respondent 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.

Respondent 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

I understand 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 it; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
 - 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. Respondent 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. Respondent 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 Respondent's: (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. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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 have been given a full opportunity to ask questions about it; that Respondent has agreed to its 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.

11/21/2016
Date (mm/dd/yyyy)


Citigroup Global Markets, Inc.

By: Joshua E. Levine
Managing Director

Reviewed by:

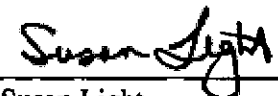


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Accepted by FINRA:

11/30/16
Date

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


Susan Light
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