

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. E9B20030263-05

TO: Department of Enforcement
NASD

RE: Citigroup Global Markets Inc.
BD No. 7059

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

We understand that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against us; and
3. If accepted:
 - a. this AWC will become part of our permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against us;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about our disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. we 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 findings in this AWC or create the impression that the AWC is

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without factual basis. Nothing in this provision affects our testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

We also understand that our experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

CGMI has been a member of NASD since 1936 and maintains its principal place of business in New York City. CGMI's disciplinary history includes the following recent actions:

On March 23, 2005, the U.S. Securities and Exchange Commission issued an Order Instituting Administrative and Cease-and-Desist Procedures against CGMI, finding that the firm engaged in mutual fund sales practice disclosure violations. Without admitting or denying the findings, CGMI agreed to the Order, which, among other things, imposed a censure, ordered the firm to cease-and-desist from further violations, imposed a \$20 million civil penalty, and ordered the firm to retain an independent consultant to review its mutual fund sales practices.

On March 22, 2005, NASD accepted an AWC from CGMI for failing to disclose the material differences among mutual fund class shares, including annual fees and availability of breakpoints to reduce or eliminate upfront sales charges. CGMI was censured and fined \$6,250,000. The firm was also ordered to hire an independent consultant to review its policies and procedures and oversee remediation to customers.

I.

WAIVER OF PROCEDURAL RIGHTS

We specifically and voluntarily waive the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against us;
- 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 NAC and then to the U.S. Securities and

Exchange Commission and a U.S. Court of Appeals.

Further, we specifically and voluntarily waive any right to claim bias or prejudice 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.

We further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of 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.

II.

ACCEPTANCE AND CONSENT

A. We hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD 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 NASD:

SUMMARY

From June 1, 2001 through June 30, 2002 (the "relevant period"), more than 100 CGMI registered representatives improperly sought sales charge waivers for hundreds of customers in connection with 2,419 mutual fund transactions totaling approximately \$47 million. Those registered representatives, in most cases, falsely claimed that their customers, including hedge funds, were disabled. Except for four hedge fund customer transactions, totaling \$21 million, that were later blocked by mutual fund companies, the representatives ultimately obtained the requested sales charge waivers for their customers.

Throughout the relevant period, CGMI did not have an adequate supervisory system and written procedures relating to waivers of mutual fund sales charges. As a result of those deficiencies, sales charges totaling approximately \$715,000 were not paid.

Moreover, the improper sales charge waivers entered by CGMI's registered representatives caused the firm's books and records to contain false information regarding the disability status of customers and their entitlement to such waivers.

BACKGROUND

A Contingent Deferred Sales Charge ("CDSC") is the sales charge that mutual fund companies impose on investors who sell/redeem their Class B shares within a certain period after purchase. CDSCs may be waived under certain circumstances as defined by

the prospectus, such as death, disability or a qualified distribution. In order to obtain a disability-based waiver for a customer, a broker may be required, pursuant to the fund prospectus and/or the dealer agreement with the fund distributor, to obtain and/or submit certain documentation evidencing the customer's eligibility for a CDSC waiver as defined by the IRS or in the particular fund's prospectus. The eligibility for a CDSC waiver is further narrowed by the timing of the disability; the waivers are generally available only when the customer becomes disabled *after* the mutual fund purchase. Further, in most cases, the disability-based waiver can be taken only up to one year after the customer becomes disabled.

CGMI was aware of the criteria established by the mutual fund companies for disability-based waivers. In 1997, the New York Stock Exchange filed disciplinary actions against two of the firm's registered representatives for obtaining CDSC waivers for their customers under false pretenses. In 1999, CGMI issued a Compliance Memo to its managers and directors advising that CDSC waivers were prohibited unless they were granted in compliance with the terms set forth in the applicable mutual fund prospectus.

During the relevant period, CGMI employed an electronic order entry system that permitted registered representatives to obtain waivers of CDSCs for mutual fund redemptions. Through this system, a registered representative was required to select a reason code for each transaction in order to process a CDSC waiver. In order to obtain waivers of a CDSC based upon customer disability, the representative would need to "tab" to a computer screen line item for CDSC waiver and enter a number "2." Therefore, disability-based waivers were not likely to be the result of an entry error.

IMPROPER WAIVERS

During the relevant period, more than 100 CGMI registered representatives improperly obtained CDSC waivers based on purported customer disability for hundreds of customers in connection with 2,415 mutual fund transactions totaling approximately \$26 million. Those registered representatives obtained the waivers in most cases by misrepresenting, on CGMI's electronic order entry system, that their customers were entitled to the CDSC waivers because they were disabled. In several instances, CGMI registered representatives even entered CDSC waivers for hedge fund customers, thereby claiming that those entities were "disabled" as defined by the IRS or in the applicable prospectus.

Moreover, CGMI lacked the supporting documentation required by certain of the applicable mutual fund prospectuses and/or dealer agreements. Accordingly, even though a small number of these customers may have been entitled to CDSC waivers, CGMI failed to make and keep records demonstrating that the customers were actually disabled as defined by the prospectus; that their disability occurred after the initial purchase of the mutual fund shares; and that proof of such disability was collected and/or submitted in the format required by the mutual fund company.

As a result of the improper CDSC waivers during the relevant period, sales charges totaling approximately \$715,000 were not paid.

SUPERVISORY DEFICIENCIES

During the relevant period, CGMI failed to have a supervisory system and procedures with respect to mutual fund transactions that were reasonably designed to ensure that its registered representatives were complying with the CDSC waiver provisions of the applicable mutual fund prospectuses and the firm's dealer agreements. Specifically, CGMI failed to maintain, update and enforce reasonable internal policies, systems and procedures in, among other things, the following respects:

1. CGMI's supervisory system was not adequate to prevent and detect improper CDSC waivers. The firm's electronic order entry system provided a simple and unsupervised method for its representatives to obtain waivers of CDSCs for customers. CGMI's supervisory system, however, had inadequate checks and balances to, among other things, ensure that registered representatives adhered to the terms of the applicable mutual fund prospectus restrictions in obtaining CDSC waivers. For example, the firm did not develop any exception reports or otherwise provide for reasonable steps to ensure registered representatives' compliance with the applicable prospectus terms.
2. In 1999, CGMI issued a Compliance Memo to its managers and directors advising that CDSC waivers could not be granted "except in circumstances specified in the fund prospectus." CGMI, however, failed to implement policies or procedures reasonably designed to ensure compliance with this directive.
3. Notwithstanding the following indications of possible misconduct by its registered representatives, CGMI failed to provide for effective follow-up and review or otherwise monitor mutual fund transactions to ensure that CDSC waivers were granted in accordance with the terms of the applicable mutual fund prospectus:
 - a. In 1997, the New York Stock Exchange filed disciplinary actions against two of the firm's registered representatives for obtaining CDSC waivers for their customers under false pretenses. The firm, however, failed to implement any new procedures reasonably designed to prevent recurrence of such misconduct, and otherwise failed to conduct a meaningful follow-up and review in subsequent years to determine whether it had successfully addressed the problems noted in the 1997 cases.
 - b. In several instances, CGMI registered representatives entered CDSC waivers for multi-million dollar mutual fund transactions by hedge fund customers, making the inexplicable claim that those entities were "disabled" as defined by the IRS or in the applicable prospectus. Four of the transactions, totaling approximately \$21 million, were blocked by the mutual fund companies, but CGMI failed to scrutinize these transactions.

- c. Over a 13-month period, CDSC waivers based on an improper and/or unsupported claim of customer disability were entered in 2,419 transactions totaling approximately \$47 million.
 - d. As noted above, a broker is often required, pursuant to the fund prospectus and/or the dealer agreement with the fund distributor, to obtain and/or submit certain documentation to support the CDSC waiver claim or, at minimum, determine that the customer is disabled. In many cases, however, CGMI registered representatives failed to obtain or submit this information or otherwise comply with such requirements. The firm had no system or procedures designed to ensure compliance.
 - e. Certain CGMI registered representatives had many customers who obtained a CDSC waiver based upon disability. For example, one representative entered disability-based CDSC waivers for over 80% of his customer base. Most of those customers were not disabled, and, in many cases, they subsequently used the proceeds to make new investments.
4. CGMI lacked written supervisory procedures relating to, among other things, proper use by representatives of its electronic order system and appropriate record keeping for CDSC waivers.

As a result of these supervisory deficiencies, CGMI violated NASD Conduct Rules 3010 and 2110.

RECORDKEEPING VIOLATIONS

The improper CDSC waivers entered by CGMI's registered representatives during the relevant period caused the firm's books and records to contain false information regarding the disability status of customers and their entitlement to such waivers.

Accordingly, CGMI violated Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-3 promulgated thereunder, and NASD Conduct Rules 3110 and 2110.

B. We also consent to the imposition, at a maximum, of the following sanctions:

- 1. censure;
- 2. a fine in the amount of \$400,000, payable within 30 days of the issuance of this AWC; and
- 3. in accordance with the first undertaking below, CGMI shall pay restitution in the amount of \$715,000 to the affected mutual fund entities in compensation for improper and/or undocumented CDSC waivers that CGMI representatives obtained for customers from June 1, 2001 through June 30, 2002. When making the restitution payments, CGMI shall include a letter informing the recipients of the matters set forth herein (including providing them with a copy of this AWC).

In addition, CGMI shall comply with the following undertakings within the time periods specified (unless otherwise extended by NASD staff following a written request by CGMI):

1. Payment of Ordered Restitution:

- a. Within 30 days of the issuance of this AWC, Citigroup shall provide NASD staff (Woodbridge District Office) with a report (the "Report") identifying the pro rata share (based on transaction amount) of the \$715,000 that the firm proposes to pay to each affected entity.
- b. If the findings detailed in the Report are not unacceptable to NASD staff (Woodbridge District Office), Citigroup shall, within 60 days of the issuance of this AWC, pay the \$715,000 to the affected entities.

2. Additional Restitution Claims:

- a. CGMI shall compile a list of the affected mutual funds for all transactions during the period January 1, 2000 through May 31, 2001 in which the customer obtained a CDSC waiver based on a disability. Within 60 days of the issuance of this AWC, CGMI shall send a letter to the fund distributors of those mutual funds, informing them of the matters set forth herein (including providing them with a copy of this AWC) and offering to provide them with all documentation in the firm's files concerning the CDSC disability waivers applicable to the particular fund. In the letter, which shall be in a form not unacceptable to NASD staff (Woodbridge District Office), CGMI shall notify the affected fund distributors that there may have been improper disability waivers or insufficiently documented disability waivers processed from January 1, 2000 through May 31, 2001.
- b. Within 130 days of the issuance of this AWC, CGMI shall provide NASD staff (Woodbridge District Office) with a report identifying the names and addresses of the recipients of the letters sent by the firm pursuant to paragraph 2(a) above, all responses received within 60 days of that mailing, and the restitution payments the firm has made or agreed to make in response to any claims submitted.

3. Certification of Payment: Within 180 days of the issuance of this AWC, an officer of CGMI shall certify in writing to NASD staff (Woodbridge District Office) that the firm has made restitution to the affected mutual funds as directed herein.

4. Supervisory System and Procedures:

- a. CGMI shall undertake to review its policies, systems and procedures (written and otherwise) and training relating to CDSC waivers for mutual fund transactions for compliance with NASD rules, the federal securities laws and regulations, and the requirements imposed by mutual fund prospectuses. CGMI shall also undertake a review of the resources employed by the firm, assess the adequacy of such resources, and make written recommendations concerning its resource needs in order to attain such compliance.
- b. Within 60 calendar days of the issuance of this AWC, an officer of CGMI shall certify in writing to NASD staff (Woodbridge District Office) that the firm: has completed its review; has implemented necessary revisions to its systems and written procedures; employs adequate staffing and resources; and has systems and procedures that are reasonably designed to achieve compliance with those laws, regulations, rules, and mutual fund prospectus requirements relating to CDSC disability waivers. CGMI's certification shall also describe the specific actions taken by the firm, including the systems and procedures developed and implemented, that are reasonably designed to achieve future compliance with those provisions.
- c. The updated procedures must be submitted to NASD staff (Woodbridge District Office). Although NASD staff may review the revised procedures, said review shall in no way constitute an approval of the revised procedures. The failure of NASD staff to alert CGMI to any deficiencies in the revised procedures shall not preclude NASD from instituting a subsequent disciplinary action as a result of deficiencies in the revised procedures.

5. Training: Within 180 days of the issuance of this AWC, CGMI shall establish a training program for all of its retail managers and retail registered representatives to provide instruction, starting no later than 2007, regarding the appropriate use of CDSC waivers, relevant prospectus requirements, and the necessary supporting documentation.
6. Quarterly Reports: No later than 60 days after the last day of each of the next four calendar quarters, beginning fourth quarter 2006, an officer of CGMI shall certify in writing to NASD staff (Woodbridge District Office) as to whether the firm reviewed all of the CDSC disability waivers granted during the quarter, verified that they were appropriately granted (or corrected those waivers not appropriately granted), and retained required supporting documentation.

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

OTHER MATTERS

- We certify that we have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce us to submit it.

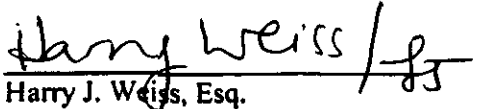
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By:

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Reviewed by:



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Accepted by NASD:

8.10.06
Date

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



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STATEMENT OF CORRECTIVE ACTION

Citigroup Global Markets Inc. ("CGMI") submits this Statement of Corrective Action in connection with its Letter of Acceptance, Waiver and Consent ("AWC") (Case No. E9B030421), dated July 31, 2006. This statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.

The AWC relates to Contingent Deferred Sales Charge ("CDSC") disability waivers obtained in connection with customers' redemption of mutual funds during the relevant period of June 1, 2001 through June 30, 2002. Since the period under review, CGMI has instituted policies and procedures that result in a robust review of CDSC waivers.

In December 2002, after learning of instances in which CDSC disability waivers were improperly obtained, CGMI implemented an enhancement to its Mutual Funds Online Surveillance System ("MCER"). Pursuant to the MCER enhancement, all orders to sell mutual funds that include a request to waive the CDSC are forwarded online to the Branch Manager for review and approval or rejection. In this fashion, a Branch Manager or other designated supervisory personnel must review and approve or reject each CDSC waiver. The MCER system has also been enhanced to provide the Branch Manager with the total number of CDSC waiver requests in a specific account for the preceding 12-month period. To further facilitate supervisory review, the MCER system was again enhanced in April 2005 to make the approval process more efficient.

Branch Managers have been provided with guidance on the approval process for these transactions. The Firm has issued several policy reminders to Financial Advisors ("FAs") and Branch Management in the past several years informing them of the requirements for each CDSC waiver type, what supporting documentation is needed and what records must be retained. An in-depth Compliance Memo was released in November 2002 that discussed CDSC waiver eligibility along with the release of the MCER enhancement relating to CDSC waivers. Additional policy enhancements/reminders were issued in April 2004 and in March 2005. As a supplement to the policy reminders, the Firm has also conducted numerous training seminars and sessions that include supervision of CDSC waivers. These training sessions consist of, but are not limited to, conference calls, workshops, and management training sessions. During these various training sessions, general CDSC waiver guidelines are discussed, as well as MCER online transaction approval requirements. Pursuant to these policies, Branch management must review each CDSC waiver and documentation supporting the waiver must be retained at the branch.

In addition to the MCER enhancement requiring management approval and review of each CDSC waiver, the Compliance Department developed a monthly exception report designed to identify FAs who have a pattern of obtaining CDSC waivers for their clients. Specifically, the report identifies those FAs who have obtained three or more CDSC waivers within a 90-day period. An additional report was created by the Compliance Department in November 2005 which captures all firm-wide CDSC waivers due to disability. Both reports are reviewed by a Compliance Department analyst who follows up with the branches in appropriate cases to ensure that particular waivers are substantiated. Waivers obtained without proper client eligibility are adjusted to reflect the appropriate CDSC amount to be charged to the client.