

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2008012808101**

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., ("CGMI" 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. CGMI 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 for violations of Rules pertaining to supervision, including the following:

In July 2009, pursuant to Letter of Acceptance, Waiver and Consent No. 20070094201, the Firm consented to a fine of \$600,000, based on FINRA's findings that in connection with a total return swap strategy, the Firm failed reasonably to supervise and control certain activities of its New York 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.

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 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.

## **OVERVIEW**

On numerous occasions during the period January 2006 through October 2007, CGMI posted inaccurate performance data and static pool information to the Reg AB website of Citigroup Inc. ("Citi") (an indirect 100% owner of CGMI). CGMI maintained this inaccurate performance data on the Citi Reg AB website until May 2012. The inaccurate performance data included information regarding delinquencies, bankruptcies, foreclosures, and real estate owned by securitization trusts, in connection with numerous residential mortgage-backed securities ("RMBS" or "securitizations"). The performance data regarding one subprime and two Alt-A RMBS was inaccurate. Further, CGMI referenced the inaccurate performance data as static pool information in one of its subsequent subprime and two of its subsequent Alt-A RMBS offerings. This inaccurate performance data and static pool information contained errors of sufficient significance such that they may have affected potential investors' assessments of these six securitizations.

In addition, CGMI posted performance data for subprime and Alt-A RMBS to the Citi Reg AB website and referenced it as static pool information when it did not possess a reasonable basis to believe that such data was accurate. CGMI received notice on numerous occasions that the data it had posted to the Citi Reg AB website was or may have been inaccurate. Moreover, once CGMI was in possession of information clearly indicating that the data it had posted on the Citi Reg AB website was inaccurate CGMI failed to amend or otherwise correct the inaccurate data it was presenting to investors.

The above deficiencies occurred, in part, as the result of CGMI's failure to establish and maintain sufficient supervisory and operations policies, procedures and systems with respect to: (1) posting of performance data to the Citi Reg AB website generally, (2) determining the accuracy of performance data prior to posting it to the Citi Reg AB website, and (3) making revisions to the performance data and static pool information as necessary.

As a result, CGMI violated NASD Rule 2110 and FINRA Rule 2010 in that it failed to observe high standards of commercial honor and just and equitable principles of trade.<sup>1</sup> By virtue of this same conduct, CGMI failed to supervise in connection with the above and violated NASD Rule 3010.

During the period July through September 2007, CGMI traders provided prices for Level 3 collateralized debt obligation (“CDO”) securities. CGMI failed to establish and maintain sufficient supervisory policies and procedures addressing independent price verification for these securities and failed to sufficiently document price verification for these securities. During this same period, in certain instances, CGMI permitted traders to re-price mortgage-backed securities held in customer accounts after the customers had disputed the original prices, and thereby changed margin requirements for those accounts. CGMI failed to establish and maintain supervisory procedures to determine the appropriateness of these re-pricings, and failed to document supervision of the re-pricings and resulting changes to margin requirements. In these instances, CGMI also failed to maintain records of the margin requirements as originally calculated. CGMI had guidance for the application of margin haircuts to collateral. CGMI failed to establish and maintain supervisory policies and procedures concerning the application of margin haircuts outside those provided for in the Firm's guidance, and failed to document supervision of the application of such margin haircuts. In instances when the margin haircut applied was lower than that set forth in the Firm's guidance, CGMI failed to demonstrate that the appropriate margin calls had been issued and required margin collected.

As a result, CGMI violated SEC Rules 17a-3(a)(8), SEC Rule 17a-4, and NASD Rules 3110 and 2110. By virtue of this same conduct, CGMI failed to supervise in connection with the above and violated NASD Rule 3010.

## **FACTS AND VIOLATIVE CONDUCT**

### **I. Background**

#### **A. Regulation AB**

Effective January 2006, the SEC adopted Regulation AB (“Reg AB”),<sup>2</sup> which set forth disclosure and other requirements regarding publicly registered asset-backed securities including RMBS. Reg AB was adopted, in part, to address a concern that the previously existing disclosure standards may not have adequately captured certain categories of information that may be material to RMBS.

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<sup>1</sup> With regard to the Firm's failure to observe high standards of commercial honor and just and equitable principles of trade, NASD Rule 2110 applies to all conduct on or before December 14, 2008 and FINRA Rule 2010 applies to all conduct on or subsequent to December 15, 2008.

<sup>2</sup> 17 CFR 229.1100 *et seq.*

## **B. Residential Mortgage-Backed Securities and Regulation AB**

RMBS are securitizations of pools of mortgage loans. RMBS investors receive payments out of the principal and interest that residential loan borrowers pay on the underlying loans. The cash flows and risks associated with the mortgage pool are distributed among multiple debt obligation classes referred to as tranches. Each tranche typically represents a different seniority of payment right in the RMBS and carries a correspondingly different level of risk. RMBS are a type of asset-backed security, and as such are subject to the requirements of Reg AB.

### **Performance Data**

During the period January 2006 through May 2012 (the “relevant period”), Reg AB required that certain performance data be disclosed in connection with an RMBS at the time of the offering and periodically thereafter. The data required to be disclosed includes, among other things, (1) present delinquency experience in 30 or 31 day increments, (2) the total amount of delinquent assets as a percentage of the aggregate mortgage pool, (3) present loss and cumulative loss information and (4) other material information regarding delinquencies and losses particular to the pool asset types by number of accounts and dollar amount (“Performance Data”).

Performance Data constitutes material information under Reg AB as it may affect an investor’s evaluation of the fair market value, yield and anticipated holding period of an RMBS. Investors may consider this information in determining the profitability of an RMBS investment and the probability of future returns on an RMBS investment being disrupted as the result of mortgage holders failing to make loan payments as scheduled.

### **Static Pool Information**

During the relevant period Reg AB required that in connection with each new RMBS offering, the registrant provide certain data regarding how prior securitizations similar in collateral content and structure performed. When RMBS Performance Data is presented in connection with a subsequent RMBS offering in this manner, it is referred to as static pool information. Specifically, Reg AB required that static pool information regarding delinquencies, cumulative losses and prepayments for prior securitized pools of the same asset type be included in the prospectus supplement for an asset-backed securities offering. Registrants of asset-backed securities offerings could elect to provide static pool information via an Internet website maintained for that specific purpose (a “Reg AB website”). If an RMBS registrant elected to provide static pool information via a Reg AB website, the registrant had to, among other things, maintain such information on the website unrestricted and free of charge for a period of not less than five years.

Static pool information constitutes material information under Reg AB as it may affect an investor’s evaluation of the fair market value, yield and anticipated holding period of an RMBS. Investors may consider this information in determining the profitability of an

RMBS investment and the probability of future returns on an RMBS investment being disrupted as the result of mortgage holders failing to make loan payments as scheduled.

During the period 2003 through 2007, CGMI underwrote and publicly sold RMBS, including but not limited to subprime RMBS, off the Citigroup Mortgage Loan Trust Inc. ("CMLTI") shelf. Subprime RMBS consist primarily, if not exclusively, of subprime mortgage loans. In order to sell a new CMLTI RMBS, CGMI was required to disclose static pool information for prior similar CMLTI securitizations. After January 2006, CGMI's prospectus supplements for new CMLTI RMBS offerings informed investors that they could view static pool information for prior similar CMLTI securitizations on the Citi Reg AB website. The Citi Reg AB website contained a hyperlink to each securitization. The hyperlink to data for a particular RMBS also displayed static pool information for similar CMLTI securitizations.

### **C. Citigroup Mortgage Loan Trust Inc. RMBS**

Certain of the entities involved in a RMBS offering (the "defined entities") include the sponsor, the depositor, the issuing entity, the servicer, the trustee and in some cases the credit risk manager. The "sponsor" organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity. The "depositor" receives or purchases and transfers or sells the pool assets to the issuing entity. (For asset-backed securities transactions where there is not an intermediate transfer of assets from the sponsor to the issuing entity, the sponsor is the depositor). The "issuing entity" is the trust or other entity created at the direction of the sponsor or depositor that owns or holds the pool assets and in whose name the asset-backed securities supported or serviced by the pool assets are issued. The issuing entity or trust issues classes of notes or certificates that comprise the different tranches of the securitization. "Servicers" are responsible for the management or collection of cash flows from the pool assets. Some RMBS also have a "master servicer," which may coordinate the efforts of one or more servicers or perform other functions. Among other things, the "trustee" or "trust administrator" publishes monthly remittance reports that set forth performance information such as payment delinquencies, bankruptcies, foreclosure proceedings, and real estate owned by the trust as the result of concluded foreclosure proceedings ("real estate owned").

Many of the RMBS at issue in this matter had a credit risk manager ("Risk Manager"). The role of the Risk Manager was to, among other things, review loan-level data provided to it by the servicer, master servicer, or trustee. The Risk Manager typically issued a report each month that identified and quantified any discrepancies between the loan-level information provided to it and the information reported by the trustee in the monthly remittance report regarding delinquencies, bankruptcies, foreclosures and real estate owned.

In connection with the CMLTI RMBS at issue, each of the defined entities involved in the RMBS was a Citigroup affiliated entity with the exception of certain of the servicers and

the Risk Manager. Each of the servicers and Risk Managers was selected by and reported to a Citigroup affiliated entity.

**D. CGMI's Role in Citigroup Mortgage Loan Trust Inc. RMBS**

CGMI was the underwriter of each CMLTI RMBS. As underwriter, CGMI was both involved in the preparation of the offering documents for each CMLTI RMBS and sold these securities to investors. Among the RMBS offering documents that CGMI participated in preparing was a prospectus supplement that described in detail the characteristics of the mortgage pool, including certain Performance Data for the mortgages that comprise the pool as of the cut-off date. During the relevant period, the prospectus supplement also referred the reader to the Citi Reg AB website.

Certain officers in CGMI's Mortgage Finance group ("Mortgage Finance") were also officers of and acted on behalf of CMLTI with respect to among other things, the receipt of information regarding the performance of the loans underlying the RMBS and filing required reports and information with the SEC.

**II. CGMI Provided Investors with Inaccurate Information and Failed to Supervise Information regarding Certain Subprime RMBS Offerings**

**A. CGMI Failed to Possess a Reasonable Basis for and Posted Inaccurate Performance Data to the Citi Reg AB Website**

CGMI posted inaccurate Performance Data on the Citi Reg AB website with regard to numerous subprime RMBS offerings when it did not have a reasonable basis to believe such information was accurate.

CGMI used the data published by trustees in the monthly remittance reports to investors as the Performance Data it posted to the Citi Reg AB website. CGMI typically received, or had access to loan level performance data for CMLTI RMBS offerings but did not use that loan level data to calculate or confirm the accuracy of the Performance Data it posted to the Citi Reg AB website. CGMI typically received, or had access to, the monthly Risk Manager reports for each CMLTI RMBS. These reports identified and quantified any discrepancies between the loan-level servicer data and the information in the trustee's monthly remittance report. The existence of these discrepancies called into question the accuracy of the data in the trustee remittance reports that CGMI posted as Performance Data.

On numerous occasions during the period January 2006 through December 2008, the monthly Risk Manager reports for approximately 22 separate CMLTI RMBS reported discrepancies between the loan-level servicer data and the Performance Data reported by the trustee in the monthly remittance reports. The Risk Manager reports indicated numerous and repeated understatement and occasional overstatement of delinquencies, bankruptcies, foreclosures and real estate owned in the trustee remittance reports,

including the possible understatement of as many as 88 foreclosures in one such trustee report and hence the Performance Data CGMI posted to the Citi Reg AB website.

During the period January 2006 through December 2008 CGMI repeatedly received, or had access to, information sufficient to inform the Firm that the Performance Data it had posted to the Citi Reg AB website may have been inaccurate. Nonetheless, CGMI failed to investigate to determine whether it had posted inaccurate Performance Data to the Citi Reg AB website and the extent to which the posted Performance Data was inaccurate and continued to rely on trustees' remittance reports as the basis for the Performance Data it posted to the Citi Reg AB website.

FINRA Rule 2010 and its predecessor, NASD Conduct Rule 2110, both require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

NASD Rule 3010 requires that firms establish and maintain a supervisory system, including written supervisory procedures related to their business, that is reasonably designed to achieve compliance with the applicable securities laws, regulations and SRO rules.

By failing to possess a reasonable basis to believe that the Performance Data it posted to the Citi Reg AB website was accurate and by posting inaccurate Performance Data to the Citi Reg AB website, CGMI violated NASD Rule 2110 and FINRA Rule 2010. By virtue of this same conduct, CGMI failed to supervise in connection with the above and violated NASD Rule 3010.

**B. CGMI Maintained Inaccurate Performance Data and Failed to Supervise Performance Data on the Citi Reg AB Website**

In or about March 2006, officers of CGMI Mortgage Finance learned that a servicer for several CMLTI subprime and Alt-A RMBS offerings ("the Servicer") had provided to CGMI and the respective trustees inaccurate calculations and reports of mortgage delinquencies, bankruptcies, foreclosures and real estate owned for several CMLTI 2005 RMBS offerings underwritten by CGMI. In September 2006, March 2007 and July 2007, CGMI again learned that it had received from servicers or trustees inaccurate information regarding the performance of loans in other CMLTI RMBS offerings it had underwritten. The inaccurate information regarding mortgage delinquencies, bankruptcies, foreclosures and real estate owned rendered certain Performance Data CGMI had posted to the Citi Reg AB website for the affected deals inaccurate. Nonetheless, CGMI did not in 2006 or 2007 correct the Performance Data it had posted to the Citi Reg AB website for the affected RMBS. CGMI did not correct the inaccurate Performance Data it posted on the Citi Reg AB website until May 2012.

Between April 2006 and June 2008, officers of CGMI Mortgage Finance, acting on behalf of CMLTI made numerous filings with the SEC disclosing and correcting inaccuracies in Performance Data previously filed with the SEC in the form of monthly trustee remittance

reports and other documents. These corrective filings disclosed the underreporting, significantly in many instances, of the number of delinquent loans and the age of those delinquencies, as well as the numbers of bankruptcies, foreclosures and real estate owned items associated with approximately 16 CMLTI RMBS offerings during the period 2005 through 2007. As noted above, CGMI did not correct any of the Performance Data it posted to the Citi Reg AB website until May 2012.

By maintaining on the Citi Reg AB website Performance Data which it knew or should have known to be inaccurate, CGMI violated NASD Rule 2110 and FINRA Rule 2010. By virtue of this same conduct, CGMI failed to supervise in connection with the above and violated NASD Rule 3010.

**III. CGMI Provided Investors With Inaccurate Static Pool Information and Failed to Supervise Static Pool Information in Connection with its Offer and Sale of Certain Subprime and Alt-A Citigroup Mortgage Loan Trust Inc. RMBS**

As noted above, during the period 2006 through May 2012, CGMI posted and maintained inaccurate Performance Data on the Citi Reg AB website for approximately 22 CMLTI RMBS offerings.

Specifically, for each of three subprime or Alt-A securitizations, Citigroup Mortgage Loan Trust Inc. Asset-Backed Pass-Through Certificates Series 2005-WF1, Series 2005-WF2 and Series 2006-HE1, CGMI posted to and maintained on the Citi Reg AB website inaccurate Performance Data regarding mortgage delinquencies, bankruptcies, foreclosures and/or real estate owned. For these three CMLTI RMBS, the Performance Data contained discrepancies that may have affected a potential investor's assessment of fair market value, certificate yield, anticipated holding periods and anticipated performance of subsequent securitizations for which these securitizations were referenced.

The inaccurate Performance Data regarding these three RMBS was provided as static pool information for three subsequently issued subprime or Alt-A RMBS, with combined notional values of approximately \$982,369,000. The offering materials for these three subsequent RMBS securitizations referred investors to the Citi Reg AB website that provided the inaccurate data.

Because of the errors in the Performance Data that CGMI posted to the Citi Reg AB website, which inaccurately reported the extent of delinquent loans, bankruptcies, foreclosures and real estate owned in the referenced securitizations, the a) fair market value, b) yields on the certificates, c) anticipated holding periods and d) anticipated performance of the subsequent RMBS may have been improperly evaluated by potential investors.

By providing investors with inaccurate Performance Data in connection with its offer and sale of certain RMBS, CGMI violated NASD Rule 2110 and FINRA Rule 2010. By virtue of this same conduct, CGMI failed to supervise in connection with the above and violated NASD Rule 3010.



**IV. CGMI Failed to Maintain Required Books and Records and Failed to Supervise the Pricing of Certain Subprime Mortgage-Backed Securities**

Sec. 17(a)(3) of the Securities Act of 1934 and SEC Rule 17a-3(a)(8) and FINRA Rule 4220 require that broker-dealers make records relating to margin debits and credits relating to customer accounts,<sup>3</sup> and SEC Rule 17a-4 and NASD Rule 3110 require that broker-dealers preserve these records for a specified period of time.

The facts and violations set forth in this section are based on findings made in connection with an examination conducted by FINRA's Department of Member Regulation in 2007 (the "2007 Exam"). The 2007 Exam reviewed CGMI's valuation controls regarding subprime asset-backed securities as such controls existed at CGMI during the period July through September 2007.

The Firm's traders priced the Level 3 CDOs held in Firm and customer accounts. A "Level 3" asset is a very illiquid asset for which fair market value cannot be calculated using observable measures such as market prices or models. A group of individuals at CGMI known as the Independent Price Verification Group was charged with independently reviewing the traders' prices. The Firm failed to establish and maintain written policies and procedures addressing independent price verification for its pricing of these CDO securities. The Firm also failed to sufficiently document its price verification process for CDO securities prior to August 2007.

CGMI utilized a "stale price report" to identify securities for which no price change was reflected in the Firm's pricing database for a specified number of days. Certain subprime securities, financed by CGMI and hand-priced by CGMI traders, failed to be included on the Firm's stale price report, even though the prices assigned to those securities had not changed for the specified number of days. CGMI could not demonstrate that it had not utilized stale prices for such securities in its business activities.

Further, on certain occasions, when a customer questioned the accuracy of a margin call resulting from the Firm's pricing of a mortgage-backed security, the Firm re-priced the security in question thereby reducing or eliminating the margin call. In these instances, the Firm failed to maintain a record of the margin call as originally calculated for the customer's account before the re-pricing, and documentation of supervisory approval for the re-pricing of the mortgage-backed security. In addition, in these instances, CGMI was unable to demonstrate that the revised price had been uniformly applied to other positions, if any, in the same security held throughout the Firm.

CGMI maintained standard guidance concerning margin haircuts to be applied to certain assets. The 2007 Exam revealed that in limited instances, margin haircuts lower than those set forth in the Firm guidance were applied to reverse purchase contracts. In these instances, CGMI could not demonstrate that the appropriate margin calls had been issued

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<sup>3</sup> At the relevant time, the record-keeping requirements imposed by FINRA Rule 4220 were addressed by its predecessor New York Stock Exchange Rule 432(a).

and required margin collected. CGMI also failed to establish and maintain written supervisory policies and procedures for supervisory review, and documented supervisory approval of the application of margin haircuts to collateral.

By virtue of the foregoing, CGMI violated SEC Rules 17a-3(a)(8), SEC Rule 17a-4, and NASD Rules 3110 and 2110. By virtue of this same conduct, CGMI failed to supervise in connection with the above and violated NASD Rule 3010.

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

- a. A censure, and
- b. A fine in the amount of \$3,500,000.

## 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 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, 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.

5/15/2012  
Date (mm/dd/yyyy)

By: Edward Turan  
Edward Turan  
Senior Deputy General Counsel  
Citigroup Global Markets Inc.

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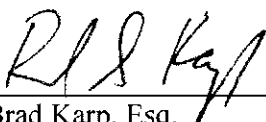
threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

\_\_\_\_\_  
Date (mm/dd/yyyy)

\_\_\_\_\_  
Citigroup Global Markets, Inc.  
Respondent

By: \_\_\_\_\_

Reviewed by:

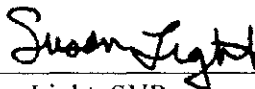


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Accepted by FINRA:

May 22, 2012  
Date

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



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