

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 79882 / January 26, 2017**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4626 / January 26, 2017**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17817**

**In the Matter of**

**Citigroup Global  
Markets, Inc.**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTIONS 203(e) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Citigroup Global Markets, Inc. (“CGMI” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party Respondent admits the Commission’s jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings pertain to violations of the Advisers Act arising out of advisory client fee overcharges by CGMI, a dually registered investment adviser and broker-dealer since 1960 with its principal place of business in New York. CGMI previously had advisory accounts both inside and outside Smith Barney, a business unit of CGMI until 2009. In 2009, hundreds of thousands of CGMI's advisory accounts within Smith Barney were transferred to Morgan Stanley Smith Barney ("MSSB") as part of a combination of the advisory businesses of the Global Wealth Management Group, a business segment of Morgan Stanley & Co. ("Morgan Stanley"), and the Smith Barney division of CGMI.

2. From at least 2000 until 2015, CGMI overcharged or caused to be overcharged at least 60,000 advisory client accounts an estimated \$18 million in unauthorized advisory fees. These overcharges have since been reimbursed with interest, to the extent they have been identified. CGMI also violated the books and records provisions of the Advisers Act with respect to maintenance of client contracts by losing or being unable to locate approximately 83,000 advisory contracts. CGMI either did not have adequate policies and procedures in place to prevent these violations of the Advisers Act or failed to implement the policies and procedures that were in place.

#### Respondent

3. CGMI is an affiliated company under the control of Citigroup Inc. ("Citigroup"), and has its principal place of business in New York. Smith Barney was a business division of CGMI until 2009, when Citigroup entered into a joint venture with Morgan Stanley to form a new entity, Morgan Stanley Smith Barney. Citigroup owned a 49 percent stake in the venture, which was gradually reduced until 2013 when Morgan Stanley completed its purchase of Citigroup's remaining interest. CGMI has been registered with the Commission since 1960 as both an investment adviser and a broker-dealer. CGMI currently has approximately 43,000 advisory accounts and \$22 billion in regulatory assets under management.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

## **Background**

4. In 2009, Morgan Stanley and Citigroup each contributed assets, clients, and accounts to the joint venture. The resulting MSSB, owned 51% by Morgan Stanley and 49% by Citigroup, had a then-combined 1.3 million advisory accounts and \$212 billion in regulatory assets under management.

5. In 2012, Morgan Stanley increased its ownership stake in MSSB by 14% and, on June 28, 2013, Morgan Stanley purchased Citigroup Inc.'s remaining interest in the joint venture. MSSB is now 100% owned by Morgan Stanley.

### **CGMI Overcharged Advisory Fees to Clients Invested in the TRAK Fund Solution Program**

6. The TRAK Fund Solution Program ("TRAK") was a wrap fee investment advisory program designed to recommend an appropriate mix of investment types based on the client's financial goals and risk tolerances. The TRAK investment recommendation provided specific advice about implementing investment decisions through a series of mutual fund investment portfolios that covered a spectrum of investments. CGMI (and its predecessor, Salomon Smith Barney Inc.) offered and sold TRAK to nearly 390,000 advisory clients between 1991 and 2011.

7. From at least 2000 through 2014, CGMI (either individually or through its participation in MSSB) charged approximately 43,000 advisory clients fees in excess of what had been negotiated by its clients. Those clients paid approximately \$13.5 million in overcharges.

8. Approximately \$8.7 million in excess advisory fees were collected from 16,000 investors who were charged a higher advisory fee than the rate disclosed to them. Individual advisory clients often negotiated an advisory fee lower than the traditional, or default, CGMI advisory fee rate. The negotiated advisory fee rate was typically documented in a client contract. Thousands of those advisory clients, however, did not receive the benefit of the lower negotiated rate because of flaws in the procedures by which negotiated advisory fee rates were entered into CGMI's computer systems. Depending on the length of time that the TRAK account was open and the amount of assets under management in that account, a client may have overpaid advisory fees by only a few dollars or by tens of thousands of dollars.

9. In certain of those client accounts, the incorrect advisory fee rate was eventually identified and changed. Some of the corrections occurred significantly later than account opening. Although the advisory fee rate was adjusted on a going-forward basis, the electronic billing records do not indicate that at the time of the correction CGMI reimbursed the clients for overcharges incurred prior to the discovery of the higher advisory fee rate. CGMI also failed to investigate other potential advisory fee overcharges at this time.

10. In addition, clients who had their advisory fee rates raised, without any authorization or notification, when they switched between CGMI's (or, between 2009 and 2011, MSSB's) branches were overcharged approximately \$3.8 million from 6,000 TRAK accounts. When client accounts were transferred between branches, a system feature caused client advisory

fees to default to the standard advisory fee; thus, clients who had negotiated lower rates began to pay the higher default advisory fee rate.

11. CGMI also collected approximately \$1 million from over 20,000 advisory clients invested in TRAK when CGMI failed to provide rebates of pre-paid advisory fees after clients terminated their accounts. TRAK accounts were billed on a quarterly basis. CGMI's practice during this time period was to charge the advisory fee prior to the end of each quarter. If the advisory client terminated their account prior to the end of the quarter (but after CGMI collected the quarterly advisory fee) CGMI was supposed to rebate a pro-rated amount of the fee. In more than 20,000 instances, however, CGMI failed to provide these rebates.

12. Finally, approximately 800 retirement accounts were overcharged approximately \$10,000 in advisory fees when certain fee reductions were not applied in a particular quarter.

13. Of the \$13.5 million in TRAK overcharges, CGMI was responsible for reimbursing, and has reimbursed, approximately \$8 million of principal and \$2.8 million in interest. Due to obligations surrounding their joint venture, MSSB was responsible for reimbursing the remaining amount of overcharges to affected clients.

#### **CGMI Overcharged Advisory Fees to "Frozen" Advisory Accounts**

14. CGMI's overbilling of its advisory clients was not limited to investors in the TRAK accounts. Between 2001 and 2015 CGMI charged over 15,000 advisory clients approximately \$3.5 million in fees for advisory services after those clients had temporarily suspended their advisory accounts (the "Frozen" accounts).

15. CGMI managed investment accounts may be frozen for a variety of reasons. CGMI did not have adequate policies and procedures in place to determine in what circumstances rebates were warranted. CGMI reimbursed all customers for advisory fees while their accounts were frozen for seven or more calendar days. When an account was temporarily frozen, advisory fees would not be billed beginning with the next billing cycle, but because advisory fees were billed prospectively, they might already have been incurred for the quarter during the billing cycle in which the account was frozen. Some investors received rebates for the interim billing cycle and some did not.

16. CGMI's overbilling of Frozen accounts occurred on its legacy and current platforms for managed accounts. CGMI overbilled approximately 11,000 accounts on its legacy platform by approximately \$2.5 million between 2001 and 2010. CGMI also overbilled approximately 4,000 advisory accounts on its current platform by approximately \$1 million between 2011 and 2015.

17. CGMI has reimbursed the \$3.5 million along with an additional \$1.1 million in interest to affected clients.

**CGMI Overcharged Advisory Fees to Recent Advisory Accounts and Accounts Not Contributed to MSSB**

18. CGMI overcharged nearly 950 advisory accounts \$1 million in advisory fees primarily between 2011 and 2014.

19. In 2011, after the migration of advisory accounts to MSSB, CGMI changed the investment platform used for its remaining advisory accounts (i.e., either newly opened advisory accounts or advisory accounts that were not part of the joint venture with MSSB.) At this time, CGMI began utilizing a new third-party platform provider for all managed accounts.

20. CGMI overcharged the accounts on the new platform in a variety of ways. First, as was the case with the TRAK accounts, in some cases CGMI simply failed to provide the investors with the lower, negotiated advisory rate. Second, as part of the conversion from the legacy platform to the new third-party platform, the negotiated rates were rounded (e.g., from four decimal places to two decimal places.) This resulted in the advisory fee rate increasing for a number of investors. Third, under a certain investment program, a .10 percent asset-based overlay manager fee was charged in addition to the advisory fee. When certain accounts were converted to the third-party platform, the overlay manager fee began to be charged twice. Finally, under a certain investment program, if a financial adviser had discretionary authority, the financial adviser was entitled to charge an additional fee of 25 percent of the basic advisory rate. However, CGMI could not verify that the advisory client had authorized this additional fee in certain circumstances.

21. CGMI has reimbursed the \$1 million in overcharges with an additional \$59,000 in interest to affected clients.

**CGMI Failed to Maintain and Preserve Certain Books and Records**

22. CGMI has failed to maintain and preserve signed client contracts in an easily accessible place as required by the Advisers Act and its internal record retention policies.

23. The Advisers Act requires advisers to maintain and preserve written client contracts in an easily accessible place for not less than five years from the end of the fiscal year during which the last entry was made. CGMI's written policies and procedures require CGMI to maintain client contracts for the life of the account plus ten years.

24. CGMI is unable to locate approximately 83,000 missing advisory contracts. These contracts are for advisory accounts that were opened between 1990 and 2012. The majority of these accounts not contributed to the joint venture were closed between 1994 and 2014.

25. CGMI cannot determine whether it overbilled clients invested in accounts for which CGMI cannot locate the advisory contract. Without the advisory contract, CGMI is unable to determine what advisory fee rate was negotiated by the advisory client and cannot, therefore, determine whether the advisory fee rate billed to the client was accurate.

26. CGMI has therefore violated the Advisers Act requirements that contracts be maintained in an easily accessible place for five years, its internal records maintenance policies requiring contracts to be kept in a readily retrievable manner during the life of the agreement plus a period of time thereafter, and its internal policy that client contracts be scanned and loaded onto the account opening portal during the account opening process.

**CGMI Failed to Adopt and Implement Written Policies and Procedures Reasonably Designed to Prevent Violations of the Advisers Act**

27. CGMI failed to adopt and implement written policies and procedures reasonably designed to prevent the above Advisers Act violations.

28. The policies and procedures in place at CGMI relating to new account opening and advisory fee billing were not reasonably designed to ensure that the correct advisory fee rate was entered for TRAK investors. CGMI failed to do sample testing of newly opened TRAK accounts for the purpose of monitoring whether investors were charged correct advisory fees. The sample testing that was done by CGMI (primarily in 2008 and 2009) reviewed only whether the advisory contracts were complete, the financial adviser's supervisor had initialed the contract and verified that the investment types were accurate.

29. CGMI lacked adequate policies and procedures that would have required escalation of advisory fee billing errors that posed, or may have posed, significant risks of overbilling so that CGMI could assess and manage those issues in an effective and timely manner. In certain client accounts, the incorrect advisory fee rate entered at the time of the account opening was later changed. For many of these accounts, CGMI has no record of why those advisory fee rates were changed or whether the investor was informed of the advisory fee rate change. Furthermore, no internal review at CGMI was conducted at the time those changes were made that may have identified the wider overbilling issue. Finally, the electronic billing records do not indicate that the investors who had their advisory fee rates changed after they opened their account were reimbursed the overbilled advisory fees at the time of that change. To the extent these investors were not reimbursed, CGMI failed to adopt policies and procedures that would have ensured that advisory clients were reimbursed for overbilled advisory fees at the time the overbilling was discovered.

30. CGMI failed to adopt written compliance policies and procedures that would have identified the increase in advisory fees in TRAK accounts when an account was transferred from one branch to another. CGMI also failed to conduct sample testing of advisory fees for these transferred accounts.

31. The policies and procedures in place at CGMI relating to the rebate of pro-rated advisory fees to investors who terminated their TRAK advisory accounts were not reasonably designed to ensure that investors received those rebates. CGMI's policies and procedures required that the client receive a termination rebate, however, those policies did not provide for any control for facilitating the return of those advisory fees to investors. Furthermore, CGMI did not conduct any advisory fee testing or other type of compliance review to ensure that the TRAK termination rebates were issued when required.

32. CGMI failed to adopt written policies and procedures to determine in what circumstances rebates to Frozen accounts were warranted for advisory fees already incurred for the quarter during the billing cycle in which the account was frozen. Although CGMI had an internal practice of allowing advisory clients to suspend their accounts, CGMI never adopted any policies and procedures to ensure that fees were not charged to advisory clients during the interim billing cycle when an account was first frozen. Neither the financial advisers, nor their supervisors, were held responsible for directing the rebate to investors in those Frozen accounts.

33. The policies and procedures in place at CGMI relating to the retention of advisory contracts and investor account information were not reasonably designed to ensure that all required documentation was maintained. CGMI did not do any testing to ensure that all client contracts were scanned in accordance with CGMI's policies.

### Violations

34. As a result of the conduct described above, CGMI willfully<sup>2</sup> violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence; scienter is not required. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992); *SEC v. Yorkville Advisors, LLC*, 12 Civ. 7728, 2013 WL 3989054, at \*3 (S.D.N.Y. Aug. 2, 2013).

35. As a result of the conduct described above, CGMI willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by the adviser and its supervised persons.

36. As a result of the conduct described above, CGMI willfully violated Section 204(a) of the Advisers Act and Rules 204-2(a)(10) and 204-2(e)(1) thereunder, which require that investment advisers maintain and preserve client contracts “in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser.”

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<sup>2</sup> A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

## Undertakings

Respondent CGMI undertakes to:

### 37. Fee Billing Undertakings

- a. For a period of 3 years from the date of this Order (the “Undertaking Period”), CGMI agrees to research and remediate the full scope and impact of all advisory fee overbilling errors discovered in the United States-based advisory business conducted through or by CGMI within 6 months from the date of discovery; if CGMI is unable to remediate the error within 6 months, CGMI shall make a report to the staff pursuant to paragraph 37(b) below, and shall remediate those issues as promptly as possible;
- b. During the Undertaking Period, CGMI agrees to provide a quarterly written report to the staff concerning advisory fee overbilling errors that have been discovered in the United States-based advisory business conducted through or by CGMI and reported pursuant to Paragraph 37(a) that affect more than one unrelated advisory account, which report shall include or describe: (i) the nature and cause of the fee overbilling; (ii) the amounts overbilled; (iii) the number of accounts overbilled; (iv) how the error was discovered; (v) the date of discovery; (vi) the status and/or date of remediation; and (viii) the amount of the remediation with interest;
- c. To the extent not already implemented, CGMI agrees within 3 months of this Order to adopt and implement enhancements to periodic fee testing reasonably designed to prevent violation by CGMI and Access Persons and other persons subject to the CGMI Code of Ethics; and
- d. At the end of the Undertaking Period, CGMI agrees to provide a certification to the staff that all advisory fee billing errors discovered during the Undertaking Period in the United States-based advisory business conducted through or by CGMI that affect more than one unrelated advisory account have been fully investigated and remediated.

### 38. Books and Records Undertakings:

- a. CGMI agrees within 6 months of this Order, to review any open advisory accounts not already reviewed by CGMI or a consultant on behalf of CGMI in order to determine whether CGMI has a copy of a signed advisory agreement for those accounts;
- b. To the extent not already implemented, CGMI agrees within 12 months of this Order, for open advisory accounts for the United States-based advisory business conducted through or by CGMI which CGMI cannot locate a signed advisory agreement, to: (i) disclose such fact to the client in writing; and (ii) if the client has not retained a copy

of the signed advisory agreement, follow the process outlined in paragraph 38(c) below;

- c. To the extent not already implemented, to enter into a new advisory agreement with a client, CGMI agrees: (i) to use all reasonable means (which shall include, without limitation, telephone calls) to contact the client and have the client enter into a new advisory agreement; and (ii) for any client who has not entered into a new advisory agreement after CGMI has complied with paragraph 38(c)(i), to send final notice to that client of the need for the client to enter into a new advisory agreement, terminate management of the account, or be subject to the terms of the current standard advisory agreement, and after 30 additional days notify the client that the account is now subject to the terms of the current standard advisory agreement or that the management of the account has been terminated. For all clients who enter into a new advisory agreement consistent with paragraph 38(c), the entry into a new advisory agreement will have no impact on the advisory fee rate charged to the account, unless it is to lower the advisory fee rate.
- d. To the extent prior to the date of this Order, CGMI entered into a new advisory agreement with a client as a result of the review undertaken by CGMI or a consultant, CGMI agrees within 12 months of the order to: (i) determine whether it had unilaterally amended any client advisory agreement that provided for amendment through mutual assent; (ii) provide the results of such study to the staff; and (iii) in the event CGMI determines that it has unilaterally amended any client advisory agreement that provided for amendment through mutual assent, notify clients who have been impacted; and
- e. CGMI agrees within 14 months of this Order to report to the staff all remedial efforts it has made with respect to the matters set forth in Paragraphs 38(a)-38(d) above.

39. Notice to Advisory Clients.

- a. Within 10 days of the Order, CGMI agrees to prominently disclose on its website a summary of the Order and provide a hyperlink to the Order, and shall maintain those posts for twelve months; and
- b. For a period of one year from the date of this Order, to the extent that CGMI is required to deliver a brochure or a summary of material changes to existing or prospective clients pursuant to Rule 204-3 under the Advisers Act, CGMI agrees to include in the brochure or summary of material changes, notice of the entry of the Order and a website address where the Order can be viewed, and provide the client or prospective client the opportunity to request a copy of the Order, which CGMI will provide upon such request.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent CGMI's Offer.

Accordingly, pursuant Section 15(b) of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act it is hereby ORDERED that:

A. Respondent CGMI cease and desist from committing or causing any violations and any future violations of Sections 204(a), 206(2), and 206(4) of the Advisers Act and Rules 204-2(a)(10), 204-2(e)(1) and 206(4)-7 promulgated thereunder.

B. Respondent CGMI is censured.

C. Respondent CGMI shall, within ten (10) days of the entry of this Order, pay disgorgement of \$3,200,000.00 and prejudgment interest of \$800,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

D. Respondent CGMI shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$14,300,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying CGMI as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate

Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, New York 10281-1022.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

F. Respondent shall comply with the undertakings enumerated in Section III, paragraphs 37-39 above.

By the Commission.

Brent J. Fields  
Secretary