UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 83859 / August 16, 2018

INVESTMENT ADVISERS ACT OF 1940
Release No. 4986 / August 16, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18647

In the Matter of **CITIGROUP GLOBAL MARKETS INC. AND CITIGROUP INC.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) 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 Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Citigroup Global Markets Inc. ("CGMI"), and that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Exchange Act against Citigroup Inc. ("Citigroup" and, together with CGMI, "Citi" or "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have 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, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

Summary

1. This matter involves CGMI's failure reasonably to supervise its traders with a view towards preventing mismarking and unauthorized trading in Citi proprietary accounts that ultimately caused CGMI's books and records, and those of its parent, Citigroup, to be inaccurate.

2. During the period from December 2014 to March 2016, CGMI discovered and reported to the Commission staff three separate instances involving mismarking by three traders, each on a different trading desk. The discovery of each mismarking resulted in the recognition of millions of dollars of previously-unreported losses or the reversal of improperly reported unrealized gains in Respondents' books and records. The three mismarking episodes overlapped in time, spanning the period mid-2013 through early 2016 (the "Relevant Period"), with each persisting for multiple quarters. All three mismarking scenarios involved opaque, illiquid positions that were overvalued by traders and not effectively price verified by Citi's valuation control group. Two of the scenarios also involved unauthorized trading in U.S. Treasury securities ("USTs"), leading to losses that were largely concealed by the mismarkings; in both of those cases, the unauthorized trading and mismarking persisted for more than a year without being detected within CGMI's supervisory framework.

3. The mismarking and unauthorized trading caused CGMI's books and records required to be made and kept pursuant to Section 17(a) of the Exchange Act and Rule 17a-3(a) thereunder, including its "[l]edgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts," to be inaccurate during the Relevant Period. The mismarking by one trader also rendered CGMI's Financial and Operational Combined Uniform Single ("FOCUS") reports filed with the Commission pursuant to Rule 17a-5 under the Exchange Act inaccurate during the Relevant Period. As a direct result of the inaccuracies in the books and records of CGMI and other affected subsidiaries, the consolidated books and records of Citigroup were inaccurate in violation of Section 13(b)(2)(A) of the Exchange Act.

Respondents

4. **CGMI** is a New York corporation headquartered in New York, New York. CGMI is an indirect, wholly-owned subsidiary of Citigroup. CGMI is dually-registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act, and as an investment adviser pursuant to Section 203(a) of the Advisers Act.

5. **Citigroup** is a financial services holding company incorporated in Delaware and headquartered in New York, New York. Citigroup's common stock is registered under Section

[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

12(b) of the Exchange Act and trades on the New York Stock Exchange (under the ticker symbol C).

Background

A. The Three Mismarking Matters

Mismarking and Unauthorized Trading on the EMCT LatAm Desk by Trader 1

6. Trader 1 was employed by CGMI as a market maker on the Emerging Markets Credit Trading Latin America ("EMCT LatAm") desk. Trader 1 was responsible for trading a book of emerging market exchange-traded funds or ETFs (the "ETF Book"), as well as managing the "Exotics Book," a legacy book comprised of derivative positions and related hedges tied to long-dated, illiquid credit-linked notes ("Exotic CLNs") referencing Latin American sovereign and corporate issuers. A CLN is a structured credit product whose value is tied to the creditworthiness of a reference entity. Under the typical CLN structure, the CLN issuer (here, a Citigroup-owned special purpose entity) is "short" the reference entity's credit, and thus benefits from increased default risk as reflected in wider credit spreads – the amounts paid in excess of the risk-free interest rate to compensate investors for the entity's credit risk – on the reference entity's outstanding credit obligations.

7. The Exotic CLNs were held by Citigroup Financial Products Inc. ("CFPI"), the direct parent of CGMI, and their performance contributed to Trader 1's compensation (which included a performance-based bonus) paid by his employer, CGMI. Moreover, the trades were executed and the positions managed and marked under the supervision of the CGMI desk supervisor. The books, records and financial results of both CGMI and CFPI were consolidated with those of Citigroup.

8. In connection with his market-making activities, Trader 1 was permitted to trade certain other products, including USTs, for hedging or risk-reducing purposes, but not for speculation. Nevertheless, between mid-2013 and the end of 2014, Trader 1 engaged in speculative trading of USTs in the Exotics Book using CGMI's internal UST trading platform, "Citi Velocity." Although intended to generate profits, Trader 1's unauthorized UST trading in the Exotics Book resulted in a net loss of $24 million in 2014 alone. Trader 1's UST positions were held by CGMI.

9. Like other traders at CGMI, Trader 1 was required to mark all his positions to fair value on a daily basis, including the Exotic CLNs. During the period in which he was sustaining large losses on his UST positions, Trader 1 mismarked the Exotic CLNs, which – unlike the ETFs in his primary trading book – had no readily observable market prices and thus very little price transparency. To mark the Exotic CLNs, Trader 1 had to input credit curves derived from the spreads on the reference entities' outstanding bonds and credit default swaps ("CDS"), which the Exotics Book held as hedges for the CLNs. By late 2014, Trader 1 was marking the Exotic CLNs using credit spreads that were in some cases double or even triple the spreads on the underlying bonds and CDSs, thus allowing him to artificially inflate the value of those CLNs, offset the UST losses, and maintain the appearance of profitability in the Exotics Book. Certain bonds held as hedges for the Exotic CLNs were also mismarked.

10. In addition to the unauthorized, speculative UST trading and mismarking in the Exotics Book, Trader 1 also booked more than 100 UST trades between the Exotics Book and the ETF Book from May 2013 through December 2014 at prices not reflective of the market price at the time of the trade ("off-market trades"). In every instance, the off-market trades were priced to the benefit of the ETF Book – the ETF Book either purchased the bonds below market from the Exotics Book or sold them above market to the Exotics Book (in some cases, both). These trades served no legitimate purpose; rather, they merely created illusory profits in the ETF Book, resulting in a total transfer of value from the Exotics Book to the ETF Book of as much as $3.7 million in 2013 and $6.5 million in 2014. These off-market trades artificially inflated the profitability of the ETF Book, Trader 1's primary trading book. The UST positions in both books were held by CGMI.

11. Trader 1's mismarking of the Exotic CLNs and related hedges was discovered in December 2014 by a junior trader managing the Exotics Book during Trader 1's two-week mandatory leave, taken pursuant to CGMI's mandatory absence policy. As of December 19, 2014, Citi calculated the size of the mismark as approximately $29 million, and re-marked the positions before Citigroup finalized its fourth quarter results. Citi also concluded that Citigroup's quarterly income had been overstated in prior periods by the following amounts: $2.9 million in Q3 2013, $1.2 million in Q4 2013, $2.4 million in Q1 2014, $2.1 million in Q2 2014, and $3.0 million in Q3 2014. CGMI placed Trader 1 on administrative leave on December 22, 2014 and terminated him on January 29, 2015, withholding his 2014 bonus.

12. By mismarking his positions and engaging in unauthorized trading, Trader 1 aided and abetted CGMI's violations of Section 17(a) and Rule 17a-3(a), and Citigroup's violation of Section 13(b)(2)(A).

Mismarking and Unauthorized Trading on the Non-Agency RMBS Desk by Trader 2

13. Trader 2 was employed by CGMI as a market maker on the Non-Agency Residential Mortgage-Backed Securities ("NA RMBS") desk. Non-agency RMBSs are securitized pools of home mortgages that are not guaranteed by the U.S. government or subject to the stringent underwriting requirements of Ginnie Mae, Fannie Mae or Freddie Mac.

14. In connection with his RMBS market making activities, Trader 2 was permitted to trade USTs for hedging purposes, but not for speculation. Trader 2, nonetheless, routinely engaged in unauthorized, speculative UST trading via Citi Velocity, executing more than 1,500 intra-day UST trades over approximately 200 trading days between May 2014 and January 2016. These trades all involved 30-year USTs, which were not appropriate hedges given that the RMBSs had expected maturities averaging seven to ten years. Trader 2 closed these trades out at the end of each day, which also was not consistent with hedging risk as the book was not sensitive to intra-day changes in rates. These UST trades were not risk-reducing, but rather were done for the purpose – although unsuccessfully – of generating profit.

15. Trader 2's unauthorized, speculative UST trading resulted in net losses of $1.67 million in 2014, $3.28 million in 2015, and $694,000 in January 2016. Most of these losses were concentrated on some 41 days on which Trader 2 lost $100,000 or more trading USTs, including one day in February 2015 when he lost $847,000 and another day in December 2015 when he

lost $554,000. These losses went undetected because Trader 2 routinely marked up his RMBS positions on days when he suffered large UST trading losses. All the relevant positions were held by CGMI.

16. Under CGMI's policies, Trader 2 was required to mark his RMBS positions to fair value on a daily basis. The marking process involved consideration of a number of factors, including recent trades (considered the best indicator of a bond's fair market value); bids, offers, and other market "color;" the present value of the bond's expected cash flows, which was determined using financial models (taking into account expected pre-payment, delinquency and default rates and other assumptions); and the perceived value of the real estate securing the underlying mortgages.

17. Beginning no later than July 2014, instead of marking the RMBSs to fair value, Trader 2 routinely marked those positions to offset his UST trading losses. On 37 of the 41 days when he suffered UST losses of $100,000 or more, Trader 2 marked up certain illiquid RMBSs in amounts that partially or completely offset those losses. The markups, however, did not reflect any changes in the market value of the RMBSs themselves. The RMBS markups were relatively small when viewed individually and typically spread across multiple positions, but when taken together the markups on any given day were generally comparable in magnitude to, and masked, Trader 2's UST losses for that day.

18. The mismarking was uncovered in January 2016 by a junior trader preparing to cover Trader 2's book during Trader 2's upcoming vacation. After an investigation, on January 25, 2016, CGMI re-marked the majority of Trader 2's RMBS positions, accounting for a reversal of improperly-recognized gains of $7.3 million as of year-end 2015 and recognizing an additional $6 million loss due to Trader 2's failure to mark down his positions as the market fell in January 2016. CGMI placed Trader 2 on administrative leave on January 25, 2016 and terminated him on March 7, 2016, withholding his 2015 performance-based bonus.

19. By mismarking his positions, Trader 2 aided and abetted CGMI's violations of Section 17(a) and Rules 17a-3(a) and 17a-5 and Citigroup's violation of Section 13(b)(2)(A).

Mismarking on the North America G-10 Rates Inflation Desk by Trader 3

20. Trader 3 was employed by CGMI as a market maker on the North America G-10 Rates Inflation desk. Trader 3 was responsible for making markets in inflation derivatives, including zero-coupon inflation options ("ZCIOs"). ZCIOs, which can take the form of either "caps" or "floors," pay out a lump sum at maturity if the cumulative rate of inflation falls above in the case of a cap, or below in the case of a floor, a specified level called the "strike."[2] The ZCIOs were held by CFPI, the books and records of which were consolidated with those of Citigroup.

21. In early 2015, CGMI discovered that Trader 3 had been marking certain ZCIOs incorrectly since at least mid-2014. The mismarked options rarely traded and had little price

[2] ZCIOs are not securities, nor are they securities-based swaps (as the underlying index, the Consumer Price Index, is not based on any security).

visibility. As such, the implied volatility of inflation – the key input in valuing these positions – had to be estimated by constructing a curve from the observable volatilities on more actively-traded ZCIOs with different strikes and maturities. At month-end, Citi's North America Valuation Control and Analytics group ("VC&A") would check Trader 3's extrapolated volatilities against consensus data provided by a third party vendor, and request an adjustment if the difference in valuation fell outside a threshold of one standard deviation, or $15 million total for the desk. Trader 3 himself did not have access to the vendor data.

22. Around mid-2014, the implied volatilities Trader 3 was using to price certain positions began to deviate from the consensus data. As discussed further below, VC&A failed to detect the deviations due to an undetected error in a spreadsheet used in its month-end price testing process that underestimated the impact of volatility variances by a factor of 100. As a result, what began as relatively small deviations from consensus pricing grew over time, and eventually became significant due to the large size of the positions.

23. During VC&A's month-end price verification process, after calculating the variances between Trader 3's implied volatilities and the consensus volatilities, VC&A would feed those variances into a price verification "spreadsheet," which multiplied the variances by each position's sensitivity to changes in volatility to calculate the dollar value of any potential mismark. Beginning no later than September 2012, the VC&A spreadsheet applied the wrong formula in its calculations, underestimating the impact of the variance between Trader 3's volatilities and the consensus data by a factor of 100. As a result, no deviations above the minimum threshold were identified, and no adjustments were taken even when Trader 3's overvaluation had grown to almost $40 million, well above the desk-level threshold of $15 million. The error remained undiscovered for more than two years.

24. The mismarking of the ZCIOs was discovered in late January 2015 after Trader 3's supervisor gave a counterparty on one of the positions an indicative bid that differed from Trader 3's mark while Trader 3 was on vacation, causing the counterparty to challenge the mark for purposes of calculating margin requirements. After an investigation, CGMI determined that the ZCIOs were overvalued by $39.4 million as of January 31, 2015. Citigroup also determined that its quarterly income had been overstated in prior periods by the following amounts as a result of the mismarking: $2.1 million in Q2 2014, $5.7 million in Q3 2014, and $12.7 million in Q4 2014. CGMI terminated Trader 3 on March 20, 2015, withholding his 2014 performance-based bonus.

B. Citi's Valuation Control and Supervisory Framework

25. CGMI had policies and procedures requiring desk supervisors to exercise general oversight over their respective traders, and to perform certain specified supervisory functions as set forth in desk-specific written supervisory procedures. CGMI also relied on other groups within Citi, including VC&A, the Product Control Group ("PCG"), and the Market Risk Management group ("Risk Management"), to provide supervisory oversight over certain areas. However, as discussed in more detail below, CGMI failed reasonably to implement those policies and procedures with respect to the EMCT LatAm and NA RMBS desks, causing the misconduct by Trader 1 and Trader 2 to go undetected for extended periods.

VC&A and the Independent Price Verification Process

26. CGMI's policies and procedures assigned responsibility for verifying valuations on the affected desks to VC&A, Citi's valuation control group for North America. Citi's Price Verification Policies and Procedures ("PV Policy") required that VC&A perform independent price verification ("IPV") on a monthly basis on all fair valued positions held by CGMI and CFPI, and maintain documentation of all IPV procedures and results. The PV Policy outlined the price testing and documentation requirements for inventory valued using Level 1, Level 2, and Level 3 inputs as defined in FASB Accounting Standards Codification 820 ("ASC 820").

27. ASC 820 defines "Fair Value" as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." ASC 820 also establishes a "fair value hierarchy" based on the quality of inputs used to determine the fair value of a position. "Level 1" applies where quoted prices are available for identical instruments in active markets. "Level 2" applies where quoted prices are available for similar instruments and/or in inactive markets, or where fair value can be derived using a model in which all significant inputs are directly observable. "Level 3" applies where one or more key inputs or value drivers is not directly observable. Relying on these definitions, the PV Policy set classifications for all fair valued inventory as Level 1, Level 2, or Level 3 according to the quality of the inputs used to value that inventory.

28. VC&A's price verification of inventory valued using Level 1 and Level 2 inputs (respectively, "Level 1 inventory" and "Level 2 inventory") generally consisted of comparing the traders' marks (or prices used to calculate fair value) to quoted market prices or consensus pricing provided by third party vendors. For inventory valued using Level 3 inputs ("Level 3 inventory"), VC&A was required to perform "additional analysis" to support the valuations. However, the PV Policy left it to the discretion of individual VC&A managers to design and implement methodologies for verifying the value of Level 3 inventory for which they were responsible. As such, IPV for Level 3 inventory varied across desks and asset classes, as did the quality of the price testing. Moreover, the PV Policy permitted VC&A to perform no "additional analysis" at all as to certain Level 3 inventory if it determined that effective price verification was not possible – in such instances, VC&A could rely on documentation provided by the desk supervisor describing the desk's marking methodology. The Exotic CLNs mismarked by Trader 1 and the RMBSs mismarked by Trader 2 were, for the most part, classified as Level 3 inventory by VC&A.

29. The purpose of the month-end IPV process was for VC&A to identify and report potential mismarks (such as variances to consensus or model-based pricing), and work with the desk supervisors to determine whether pricing adjustments were necessary. The PV Policy mandated that VC&A "strive to source external pricing data for all inventories," and required VC&A to establish thresholds above which variances to external pricing data were to be reported to and discussed with the desk supervisors. As discussed further below, CGMI failed reasonably to implement the PV Policy with respect to the affected desks.

30. In particular, CGMI failed reasonably to implement the PV Policy's requirement that VC&A perform independent price verification monthly on all fair valued positions held by the affected desks, by failing to address whether: (1) VC&A reported price variances on the

Level 3 Exotic CLNs and RMBSs to the desk supervisors and made adjustments to those prices as necessary; (2) VC&A's lack of "additional analysis" on the Level 3 Exotic CLN marks was reasonable under the circumstances, including whether Trader 1 was in fact following the documented marking methodologies the desk supervisor had provided to VC&A years earlier; and (3) VC&A independently back-tested at month-end Trader 2's marks on the Level 3 RMBSs, or otherwise took sufficient steps to verify that those marks were reasonable.

Respondents were Made Aware of Concerns Regarding Sufficiency of Resources Devoted to Price Verification throughout the Relevant Period.

31. VC&A was understaffed during the Relevant Period. Between January 2012 and March 2014, Citi eliminated 15 valuations and related financial control positions in North America, as part of a global "efficiency" initiative that saw 50 such positions eliminated worldwide. Following this reduction, Citi had 34 dedicated valuations personnel for the North America region, which included all three affected desks. During that process, many IPV functions were consolidated or transferred to staffers with little valuations training.

32. In February 2014, Citigroup's outside auditor advised Citigroup and CGMI management that "[d]uring the course of our 2013 audit of Citigroup, we have observed that Global Valuation and Finance resources available to perform price verification procedures are limited, are currently working at capacity and may become insufficient as increasing demands and responsibilities are placed on these valuation resources."

33. Similar concerns were raised internally by Citi valuations personnel, including the VC&A managers responsible for two of the affected desks. In January 2014, the VC&A manager with responsibility for the EMCT LatAm desk warned his superiors that only four individuals were tasked with price verifying more than 20 desks which together held $200 billion of Level 2 and $23 billion of Level 3 inventory, complaining that "[IPV] work is being too concentrated" and "[p]rojects are being dumped on me without adequate support." The VC&A manager also warned of gaps in the price testing of certain Level 3 inventory, including Trader 1's Exotic CLNs. Around the same time, the VC&A manager with responsibility for the NA RMBS desk advised his superiors that his group was significantly understaffed and that as a result certain important IPV functions were not being performed, including verification of some of Trader 2's RMBS products that CGMI later determined to be mismarked.

34. In mid-2014, Citi began hiring additional valuations personnel, adding 10 new positions in North America by early 2015. However, concerns over the sufficiency of Respondents' valuation controls continued throughout the Relevant Period. For instance, in November 2014, senior VC&A managers were scheduling internal meetings to address the lack of a "consistent framework globally" for IPV of Level 3 inventory, a concern that was echoed in numerous internal communications after the first mismarking surfaced the following month.

35. In Q4 2015, Citigroup's Internal Audit group ("IA") undertook a review of Respondents' valuation controls, the results of which were shared with CGMI management. IA concluded that only "limited assurance" could be placed on the design and effectiveness of Citi's valuation policy, governance and control framework. Among the high-level issues identified by IA were: (i) "lack of consistent application of the Citi-wide valuation policy across segments

and regions… [giving] rise to gaps and inconsistency in the governance framework," as well as in the setting of price-testing thresholds, the use of vendor pricing data, and the application of alternative procedures to verify Level 3 inventory, among other areas; (ii) "limited formalized guidance on valuation methodologies to be applied by VC&A;" and (iii) "insufficient personnel engaged in performing valuation control activities."

36. Ultimately, IA identified "lack of sufficient resources" as the "root cause" of several of the issues identified in the audit, finding that "continuing resource or cost management programs have impeded management's ability to maintain the appropriate level of control" over the valuation process.

VC&A Failed to Detect the Mismarkings for Extended Periods.

VC&A Failed Reasonably to Price Verify Trader 1's Exotic CLNs.

37. VC&A performed no substantive price testing on the Exotic CLNs marked by Trader 1, all of which were classified by VC&A as Level 3. Instead, it relied on a qualitative IPV approach it called Market Value Movement ("MVM") analysis. This essentially consisted of reporting the total market value of each Level 3 product type held by the desk at month-end, and identifying the drivers of significant changes in total value from the prior month (including, for example, new trades, the unwinding of a position or a reclassification of inventory between Level 2 and Level 3). Individual positions classified as Level 3 were not reviewed or price tested on a monthly basis, despite the PV Policy's requirement that all positions be independently price verified monthly.

38. Once per quarter, VC&A expanded its MVM analysis of Trader 1's Level 3 CLN positions to report to the desk head the change in valuation of each position from the prior quarter. Even in these quarterly reviews, however, there is no evidence that VC&A attempted to investigate the cause of position-level movements or otherwise verify the accuracy of Trader 1's Exotic CLN marks or underlying inputs. Indeed, throughout 2014, each of the quarterly Level 3 review reports included the following notation with respect to the Exotic CLNs: "Investigation required for these positions." However, no such investigation was ever done on the positions, even in instances where the valuations were inconsistent with observable market movements.

39. As noted, Citi's PV Policy permitted VC&A to forego the required "additional analysis" on Level 3 inventory where it determined that such additional analysis was not possible, provided the desk supervisor had adequately documented the desk's marking methodology. In this case, however, quantitative price testing of the CLNs was possible using data already available to VC&A – VC&A could have constructed benchmark credit curves using Level 2 bonds and CDSs, which the desk held and which VC&A verified monthly to external data. But because there was only one VC&A staffer assigned to price verify the $25 billion in gross inventory of the EMCT LatAm desk (in addition to several other desks), VC&A had not yet developed quantitative price testing methodologies for the Exotic CLNs. This is despite the fact that those positions had been on the desk's books for many years.

40. Moreover, the documented marking methodologies VC&A had obtained from the desk supervisor did not reflect the way Trader 1 was actually marking the Exotic CLNs during

the Relevant Period. On their faces the documented methodologies dated back several years, in some cases pre-dating Trader 1's arrival on the desk, and had not been updated since. While the PV Policy stated that traders may not deviate from the marking methodologies provided to VC&A without the approval of the desk supervisor and VC&A, CGMI failed reasonably to implement that policy, for example by requiring that the desk supervisor or VC&A take steps to verify that Trader 1 was actually following the documented methodologies. Here, VC&A and the desk supervisor simply relied on Trader 1's good faith adherence to the documented methodologies; during the Relevant Period, however, Trader 1 was not following the documented methodology for any of the Exotic CLNs.

41. In September 2014, a director in CGMI's Markets Quantitative Analysis group ("MQA") assigned to the EMCT LatAm desk discovered that Trader 1 was marking one of the Exotic CLNs using a credit curve that was inconsistent with the underlying credit curve for the reference entity and also with the documented marking methodology. The MQA director questioned Trader 1 about the discrepancy, but did not escalate the issue to the desk supervisor or to VC&A.

42. On at least six occasions in 2014, VC&A questioned Trader 1 about "aggressive" marks on certain Level 2 bonds he held as hedges for one of the Exotic CLNs. Each time, Trader 1 claimed his marks were based on quotes provided by a single dealer, which were higher than the consensus prices VC&A obtained from vendors. VC&A accepted Trader 1's explanations, notwithstanding that the PV Policy afforded greater weight to consensus pricing than to individual dealer quotes. VC&A did not report these instances of "aggressive" marking to Trader 1's supervisor, and did not require him to take adjustments. Trader 1 continued to mark up the bonds, one of which the desk later marked down by $1.5 million in December 2014.

VC&A Failed Reasonably to Price Verify Trader 2's RMBSs.

43. VC&A failed reasonably to price verify Trader 2's mismarked RMBSs, the majority of which were classified by VC&A as Level 3. As part of the month-end IPV process for the desk, VC&A's automated systems calculated a potential profit-and-loss ("P&L") impact for each position based on the difference between the trader's mark and the median vendor price. The variances on Level 2 inventory were reflected in month-end reports to the desk supervisors, and adjustments were automatically taken if the aggregate impact exceeded a $20 million threshold.

44. VC&A had access to vendor pricing for the Level 3 inventory as well. However, because it considered the vendor data insufficiently reliable to classify the inventory as Level 2, VC&A did not report the variances on such inventory held by the desk, notwithstanding the PV Policy's general requirement that VC&A report significant variances to external pricing data to the desk supervisors.

45. Notably, the five most heavily mismarked Level 3 RMBSs, as determined by CGMI in January 2016, had consistently shown large aggressive variances to vendor prices month after month throughout 2015, often in the millions of dollars – indeed, in March 2015, the combined variances versus vendor prices on those five positions alone as calculated by VC&A approached $17 million. But because the products were classified as Level 3, the monthly

variances were never reported to the desk supervisors, and no adjustments were taken on those positions.

46. Instead of re-marking Level 3 inventory to bring the marks in line with consensus data, VC&A relied primarily on "commentary" provided by the trader, in which the trader explained the basis for each mark, including the key assumptions used in modeling the expected cash flows and any relevant market activity. VC&A staff was tasked with assessing the reasonableness of the trader's explanation and using it to back-test the mark. However, due to resource and time constraints, most inventory classified as Level 3 (including the RMBSs) was not back-tested at month-end, and VC&A staff did not critically assess the reasonableness of the trader's explanations.

47. Indeed, much of Trader 2's commentary was inadequate on its face to support his RMBS valuations, but VC&A did not have enough experienced personnel to critically review the commentary and follow up as necessary. And VC&A did not obtain commentary on several of Trader 2's most heavily mismarked Level 3 RMBSs, which had (apparently incorrectly) been designated as "Low Risk" by VC&A personnel. As a result of that designation in VC&A's systems, no further price verification was required as to those positions.

C. Other Supervisory Failures

CGMI Failed Reasonably to Design and Implement Supervisory Procedures and Systems Concerning UST Trading and Related Risk Limits.

48. CGMI's policies and procedures imposed certain restrictions on traders, including the types of products they could trade and for what purpose (for instance, whether they could engage in speculative trading), as well as the amount of risk they could incur on CGMI's behalf. CGMI failed reasonably to implement those policies and procedures with respect to USTs on the EMCT LatAm and NA RMBS desks, for example by means of systems-based controls or supervisory staff oversight, and thus failed to prevent and detect the unauthorized UST trading by Trader 1 and Trader 2.

49. As discussed further below, both Trader 1 and Trader 2 requested and were granted increased access to Citi Velocity during the Relevant Period, without obtaining permission from their supervisors, and both used such access to expand their unauthorized UST trading. And CGMI's trading platforms and trade capture systems themselves, including Citi Velocity, lacked safeguards to prevent or detect Trader 1 and Trader 2's unauthorized, speculative trading in USTs that created additional risk for CGMI.

50. CGMI's desk supervisors shared with other supervisory and control personnel responsibility for enforcing trading mandates and risk limits. CGMI relied on Citi's Product Control Group (PCG) to identify and report significant trades, in addition to providing daily P&L reports to each desk supervisor. However, PCG did not effectively perform this task.

51. For example, PCG was required to get commentary from traders on the NA RMBS desk as to any "significant trades," or individual trades resulting in a profit or loss greater than $250,000. But because PCG's automated reporting system did not capture intra-day trades

or aggregate multiple trades in the same CUSIP, the vast majority of Trader 2's unauthorized, speculative UST trades were not flagged as "significant" or sent out for commentary. However, in March 2015, a PCG employee noticed a particularly large UST loss in Trader 2's book and questioned Trader 2 about it, while noting that sizable intra-day UST losses seemed to be an "everyday occurrence" for Trader 2. Trader 2 responded that it was "just a hedge," and the PCG employee accepted this explanation without further inquiry or referral to the desk supervisor, notwithstanding that those 30-year USTs were not appropriate hedges for Trader 2's book. Because the PCG employee was not trained to distinguish between legitimate hedges and speculative trades, and was not familiar with the desk's trading mandate, he did not know the trades themselves were unauthorized and thus did not report the issue to Trader 2's supervisors.

52. Similar process failures prevented PCG and other supervisory personnel from discovering Trader 1's unauthorized UST trading. In July 2013, PCG questioned Trader 1 about one of his early off-market interbook trades. In response, Trader 1 complained that restrictions on his access to Citi Velocity required him to transfer UST positions between his books. PCG did not investigate his suspicious trading further. And, without consulting Trader 1's supervisor, a PCG employee requested that Trader 1 be granted full access to Citi Velocity, allowing him to execute UST trades directly to and from each book. Thereafter, the volume of Trader 1's UST trading, including his interbook trading, increased dramatically. Notably, Trader 2 also requested, and was granted, access to Citi Velocity in early January 2016 for certain proprietary accounts that previously did not have such access (again without approval from the desk supervisors), leading to additional unauthorized UST trading and further losses of $223,000 in those accounts before Trader 2's misconduct was uncovered later that month.

53. CGMI relied on Citi's Market Risk Management group to establish and monitor compliance with risk limits above the desk level, such as Citi-wide (Tier 1) or business-level (Tier 2) risk limits. In August 2014, a Tier 2 interest rate risk limit was breached within the Global Credit Markets business, which includes the EMCT LatAm desk, and Risk Management identified Trader 1 as primarily responsible for causing the breach. Risk Management discovered that Trader 1's UST exposure was more than double the size necessary to hedge his overall interest rate risk, and that he had lost approximately $16 million year-to-date on his UST trades. In response to the breach, Risk Management temporarily raised the interest rate risk limit, and accepted Trader 1's assurance that he would reduce his exposure going forward. He did so only temporarily, and ultimately his UST losses grew to $24 million by year-end. Risk Management did not report Trader 1's excessive interest rate risk or his UST losses to the desk supervisor.

CGMI Failed Reasonably to Design and Implement Supervisory Procedures and Systems at the Desk Level.

54. CGMI's desk supervisors (in particular, the desk heads) shared with VC&A responsibility for verifying marks, and they shared with Risk Management responsibility for supervising compliance with trading mandates, risk limits and other trading restrictions. Indeed, under CGMI's supervisory framework, desk supervisors were considered the "first line of defense" against unauthorized trading, improper valuations, and other trader misconduct. However, CGMI failed reasonably to implement those policies and procedures with respect to the EMCT LatAm and NA RMBS desks.

55. Citi's PV Policy stated that "[i]t is the Desk Head's responsibility to ensure that the positions are marked to market timely and accurately according to these procedures," subject to independent review by VC&A at month-end. CGMI failed reasonably to implement this policy on the affected desks, because the desk-specific written supervisory procedures did not require the desk heads to review the traders' marks, marking methodologies or relevant inputs, or take other steps to verify the accuracy of the valuations. Without such monitoring, the desk heads had no practical ability to ensure that traders marked positions appropriately, and did not detect the mismarkings by Trader 1 and Trader 2.

56. Citi's Mark-To-Market Risk Policy ("MTM Risk Policy") and its Policy Governing Trading Desk Mandates and Permitted Products required desk supervisors to ensure compliance with applicable trading mandates and to report breaches to Risk Management. CGMI failed reasonably to implement those policies on the affected desks, because the desk-specific written supervisory procedures did not require the desk supervisors to review trade blotters or daily P&L reports or otherwise monitor trade activity for compliance with the policies.

57. Indeed, Trader 2's desk supervisors received multiple reports each day by e-mail that showed Trader 2's intra-day trades and losses in 30-year USTs, as well as RMBS prices with markups that effectively offset those losses. But because the supervisors were not required to review those particular reports, Trader 2's unauthorized trading and mismarking went undetected for a year and a half. Similarly, Trader 1's supervisor was not required to, and did not, review trade reports that showed Trader 1's unauthorized UST trading, which also lasted for a year and a half.

58. The MTM Risk Policy also required the supervisors on each desk to review customized risk limit reports provided by Risk Management on a daily basis, and to establish and enforce desk-level (Tier 3) risk limits – which were separate from, and in addition to, the Tier 1 and Tier 2 limits set by Risk Management. CGMI failed reasonably to implement this policy because the firm did not provide guidance to desk supervisors regarding what risk metrics should be monitored at the Tier 3 or desk level. Trader 1 and Trader 2's desk supervisors did not monitor or establish desk-level limits for interest rate risk, nor was interest rate risk included in the risk limit reports they received from Risk Management. Consequently, the desk supervisors did not uncover the unauthorized UST trading by Trader 1 and Trader 2.

59. Finally, the various supervisory and process failures discussed above were compounded by the fact that CGMI lacked reasonable procedures and systems to ensure that compliance breaches and other indicia of misconduct relating to valuations and trading that were detected were properly escalated and addressed. For instance, had breaches such as Trader 1's deviation from approved marking methodologies, discovered by MQA in September 2014; excessive interest rate risk and resulting losses, discovered by Risk Management in August 2014; "aggressive" marks on externally-verified bonds, known to VC&A throughout 2014; and off-market interbook UST trading, discovered by PCG in July 2013; or Trader 2's losses from intra-day trading in 30-year USTs, flagged by PCG in March 2015, been shared amongst the different control groups and desk supervisors, CGMI would have been more likely to uncover the unauthorized trading and mismarking earlier.

D. <u>Violations and Failure Reasonably to Supervise</u>

60. As a result of the conduct described above, CGMI willfully violated Section 17(a) of the Exchange Act and Rules 17a-3(a) and 17a-5 thereunder, which require broker-dealers to make and keep accurate books and records and file accurate FOCUS reports.

61. As a result of the conduct described above, CGMI failed reasonably to supervise Trader 1 and Trader 2 pursuant to Section 15(b)(4)(E) of the Exchange Act.

62. As a result of the conduct described above, Citigroup violated Section 13(b)(2)(A) of the Exchange Act, which requires public companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

E. <u>Respondents' Remedial Efforts</u>

63. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff. Respondents conducted an internal investigation of each matter with the assistance of outside counsel; terminated the responsible traders for cause; self-reported each matter to the staff; produced documents, made current and former employees available, and undertook additional forensic analyses at the staff's request; and implemented certain improvements to their valuation controls and supervisory procedures.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. CGMI cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rules 17a-3(a) and 17a-5 thereunder.

B. CGMI is censured.

C. Citigroup cease and desist from committing or causing any violations and any future violations of Section 13(b)(2)(A) of the Exchange Act.

D. CGMI and Citigroup shall, within ten (10) days of the entry of this Order, pay jointly and severally a civil money penalty in the amount of $5,750,000 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) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents 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) Respondents 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 and Citigroup as Respondents 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 Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY, 10281.

By the Commission.

Brent J. Fields
Secretary