

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2016050947701**

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**

CGMI has been registered as a broker-dealer with FINRA or its predecessors since 1936. The Firm has its principal place of business in New York, New York. CGMI is a full-service firm that engages in a general securities business. CGMI employs approximately 7,400 registered individuals and has approximately 750 branch offices.

**RELEVANT DISCIPLINARY HISTORY**

CGMI has no relevant formal disciplinary history with the Securities and Exchange Commission, any state securities regulator, or any self-regulatory organization.

**OVERVIEW**

From February 2011 to February 2017 (the “Relevant Period”), CGMI failed to identify and apply sales charge discounts to certain eligible purchases of Unit Investment Trusts (“UITs”), in violation of FINRA Rule 2010.

In addition, CGMI failed to supervise purchases and sales of UITs in two respects. First, the Firm failed to establish, maintain and enforce a supervisory system and written supervisory procedures (“WSPs”) reasonably designed to achieve compliance with applicable securities laws, regulations, and FINRA rules regarding the crediting of all available sales charge discounts to customers’ eligible UIT purchases. Among other things, the Firm had no WSPs that discussed the application of rollover discounts and no surveillance tools to identify available rollover discounts. Second, CGMI failed to establish, maintain and enforce a supervisory system and WSPs reasonably designed to supervise UIT trading. The Firm’s surveillance alert system to detect switching of UITs and other products inadvertently excluded UITs from consideration, which CGMI failed to discover for years. As a result, CGMI violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

### **FACTS AND VIOLATIVE CONDUCT**

#### **1. *Origin of the Matter***

This matter arose out of a firm examination conducted by FINRA’s Department of Member Supervision.

#### **2. *UIT Trading Costs and Discounts***

A UIT is a SEC-registered investment company that offers shares or “units” in a portfolio of securities in a public offering. Generally, a UIT’s portfolio is not actively traded and follows a “buy-and-hold” strategy. UITs terminate on a specified maturity date, often after 15 or 24 months, at which point the underlying securities are sold and the proceeds are paid to investors.

UITs impose a variety of sales charges. For example, during the Relevant Period, a typical 24-month UIT imposed: (1) an initial sales charge, which was 1% of the purchase price; and (2) a deferred sales charge, which was up to 2.5% of the offering price. Also, most UIT sponsors charged a creation and development fee (“C&D fee”), which was generally 0.5% of the offering price.<sup>1</sup> The initial sales charge generally was charged at the time of purchase; the deferred sales charge and C&D fee typically were charged during months three through six of the UIT’s duration.

UIT sponsors offer investors a variety of ways to reduce the sales fee charged on a UIT purchase. During the Relevant Period, the two most common methods to reduce the fee were “breakpoints,” which allowed investors to reduce the sales fee by increasing the size of their UIT investments, and discounts on “rollovers” and “exchanges” (collectively “sales charge discounts”).

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<sup>1</sup> In addition to these charges, most UITs charge annual operating expenses that are paid to the sponsor out of the assets of the UIT.

Because of the long-term nature of UITs, their structure, and upfront costs, short-term trading or switching of UITs may be improper. Firms should therefore establish, maintain and enforce a supervisory system and WSPs reasonably designed to detect short-term trading or switching of UITs.

**3. *CGMI Failed to Identify and Apply Sales Charge Discounts for UIT Purchases***

FINRA Rule 2010 states that “[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.”

During the Relevant Period, CGMI failed to identify and apply sales charge discounts to certain customers’ eligible purchases of UITs. There were 1,476 transactions at CGMI eligible to receive a rollover discount in addition to or independent of a breakpoint discount during the Relevant Period. CGMI failed to apply sales charge discounts to 594 of these eligible UIT purchase transactions, resulting in customers paying excessive sales charges of \$152,488.59.<sup>2</sup> By virtue of the foregoing, CGMI violated FINRA Rule 2010.

**4. *CGMI’s UIT Supervision***

FINRA Rule 3110 and its predecessor, NASD Rule 3010, require that each member firm establish and maintain a system, and establish, maintain and enforce written procedures, to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules.

On March 31, 2004, FINRA issued Notice to Members 04-26, *Unit Investment Trust Sales*, which reminded broker-dealers that they should develop and implement procedures to correctly apply available sales charge discounts for UITs. The Notice further stated that UIT transactions must take place “on the most advantageous terms available to the customer” and that it is the firm’s responsibility to “take appropriate steps to ensure that they and their employees understand, inform customers about, and apply correctly any applicable price breaks available to customers in connection with UITs.”

During the Relevant Period, CGMI failed to establish, maintain and enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws, regulations, and FINRA rules regarding the crediting of all available sales charge discounts to customers’ eligible UIT purchases. While CGMI had WSPs governing UIT breakpoint discounts and utilized reports and

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<sup>2</sup> CGMI has already repaid this amount in full, plus statutory interest, and provided proof of payment to FINRA staff.

other surveillance tools to ensure breakpoint discounts were credited, they did not have a similar system for rollover discounts. Rollover discounts were not discussed in the Firm's WSPs, and the Firm had no surveillance tools to identify applicable rollover discounts. In April 2017, CGMI adopted new supervisory procedures regarding the application of rollover discounts to all eligible UIT transactions going forward.

In addition, during the Relevant Period, CGMI failed to establish, maintain and enforce a supervisory system and WSPs reasonably designed to supervise the trading of UITs. CGMI had WSPs specific to UIT suitability that cautioned against short-term trading. In order to implement these WSPs, the Firm employed both "pre-trade" and "post-trade" systems to supervise UIT trading and monitor for inappropriate UIT switches.

CGMI's "pre-trade" procedures were designed to be embedded in the order entry process. If a registered representative indicated at the time of order entry that there had been a trade involving the UIT within the previous 60 days, then the transaction was reviewed by a supervisor. The pre-trade system required registered representatives to self-identify trades that would be subject to additional supervisory scrutiny. In addition, CGMI's WSPs provided for a "post-trade" control which should have automatically flagged short-term UIT trades as potential switches even if not identified by the registered representative at the time of order entry and generated an alert. Notwithstanding the design of the pre- and post-trade procedures, CGMI's supervisory system nonetheless was not reasonable because the Firm failed to conduct any testing to ensure that short-term UIT trades were being flagged. Because of this failure, CGMI failed to discover that the post-trade system used by the Firm to flag short-term trading mistakenly excluded UITs from the time of the system's adoption in February 2011. During the Relevant Period, the Firm tested the model twice for mutual fund activity, but never conducted any testing to ensure that UIT trades were being flagged. In July 2017, the model was updated to include UITs and has been tested by the firm to ensure that short-term UIT trades generate alerts.<sup>3</sup>

Based on the foregoing, CGMI violated NASD Rule 3010, and FINRA Rules 3110 and 2010.<sup>4</sup>

- B. Respondent also consents to the imposition of the following sanctions:
- A censure;
  - A fine in the amount of \$225,000; and

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<sup>3</sup> In determining the appropriate monetary sanction, FINRA considered, among other things, that UITs accounted for approximately 1% of the Firm's retail business. While the Firm's system was not reasonable during the Relevant Period and created risk of customer harm, no customer harm was identified in the transactions reviewed in this matter.

<sup>4</sup> The Firm violated NASD Rule 3010 for its conduct prior to December 1, 2014 and FINRA Rule 3110 for its conduct on and after that date.

- Restitution in the amount of \$152,488.59, plus interest.<sup>5</sup>

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

Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

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

## II.

### WAIVER OF PROCEDURAL RIGHTS

CGMI specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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, CGMI specifically and voluntarily waives any right to claim bias or prejudice of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated

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<sup>5</sup> As noted above, CGMI paid full restitution, plus statutorily calculated interest, and provided proof of payment to FINRA Staff.

the *ex parte* prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

### III.

#### OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
  - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
  - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
  - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
  - 4. CGMI may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

6/5/2019  
Date (mm/dd/yyyy)

Respondent Citigroup Global Markets Inc.

By:   
Joshua Levine  
Director and Associate General Counsel

Reviewed by:

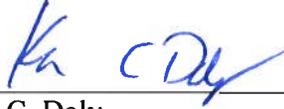


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Accepted by FINRA:

June 20, 2019  
Date

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



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