

**STATE OF WISCONSIN
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF SECURITIES**

In the matter of)	
)	
Citigroup Global Markets Inc.)	ADMINISTRATIVE CONSENT ORDER
388 Greenwich Street)	
New York, NY 10013)	File No. S-09140(EX)
Respondent.)	
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)	

WHEREAS, Citigroup Global Markets Inc. (“CGMI”) is a broker-dealer registered in the state of Wisconsin; and

Coordinated investigations into CGMI’s activities in connection with CGMI’s marketing and sale of auction rate securities (“ARS”) have been conducted by a multi-state task force; and

CGMI has provided documentary evidence and other materials, and provided regulators with access to information relevant to their investigations; and

CGMI has advised regulators of its agreement to resolve the investigations relating to its marketing and sale of ARS to certain investors; and

CGMI agrees, among other things, to reimburse certain purchasers of ARS, and to pay certain monetary penalties at the direction of the Wisconsin Department of Financial Institutions-Division of Securities (“Division”); and

CGMI elects to waive permanently any right to a hearing and appeal under sec. 551.61, Wis. Stats., the Hearings and Judicial Review statute which was applicable during the relevant time period with respect to conduct related to this Consent Order (the “Order”);

NOW, THEREFORE, the Division, as administrator of the Wisconsin Uniform Securities Law applicable during the relevant time period, hereby enters this Order.

I.

FINDINGS OF FACT

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3 1. CGMI admits the jurisdiction of the Division, neither admits nor denies the Findings of
4 Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by
5 the Division.

6 2. CGMI (which includes Smith Barney, a division of CGMI) has engaged in the sale of ARS
7 in the state of Wisconsin.

8 **Auction Rate Securities**

9 3. ARS as a general term refers to long-term debt or equity instruments tied to short-term
10 interest rates that are reset periodically through an auction process.

11 4. An ARS auction is regarded as a “fail” or “failed auction” if there is not a buyer available
12 for every ARS being offered for sale at the auction. In the event of a failed auction, the investors
13 that wished to sell their ARS were unable to do so and would continue to hold the ARS and wait
14 until the next successful auction to liquidate their positions.

15 5. Beginning in February 2008, the ARS market experienced widespread failed auctions (the
16 “2008 Auction Failures”).

17 6. Common categories of ARS instruments include: auction preferred shares of closed-end
18 funds (“Preferreds”); municipal auction rate certificates (“Municipal ARS”); and student loan-
19 backed auction rate certificates (“Student Loan ARS”). The interest rates paid to ARS holders are
20 intended to be set through a Dutch auction process.

21 7. The interest rate set at an ARS auction is commonly referred to as the “clearing rate.”
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1 8. In order to determine the clearing rate, the buy bids are arranged from lowest to highest
2 interest rate (subject to any applicable minimum interest rate). The clearing rate is the lowest
3 interest rate at which all ARS available for sale at the auction can be sold at par value.

4 **CGMI's Activities in the ARS Market**

5 9. Trading of ARS at CGMI is performed by the Short-Term Tax-Exempt Sales and Trading
6 Desk ("Auction Desk").

7 10. CGMI's Auction Desk includes traders and sales coordinators. The sales coordinators on
8 the Auction Desk at times provided information to, and answered questions from, CGMI's
9 financial advisers regarding ARS.

10 11. For approximately twenty (20) years, CGMI has been an underwriter of ARS. The
11 compensation earned for underwriting activities of Preferreds is typically one percent (1%) of the
12 outstanding amount of the ARS underwritten. Since the late 1990s, the compensation for
13 underwriting other types of ARS has generally been a fraction of one percent (.25% to .35%) of the
14 outstanding amount of ARS underwritten.

15 12. CGMI's ARS underwriting activities are primarily handled by investment bankers. The
16 Auction Desk often consulted the investment bankers with respect to various ARS matters.

17 13. The cost of the financing to issuers is directly related to the clearing rates set at the auctions
18 for the issuer's ARS. As an underwriter, CGMI had an interest in providing low-cost financing to
19 the issuers of the ARS that it underwrote because its ability to provide low-cost financing affected
20 the possibility of additional underwriting business.
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1 14. CGMI typically served as a manager of ARS auctions. CGMI's roles for each auction
2 were typically set forth in a broker-dealer agreement entered into between CGMI and the ARS
3 issuer.

4 15. CGMI often served as the sole manager of ARS auctions or as the co-manager of auctions
5 with other large broker-dealers.

6 16. CGMI's compensation for serving as an ARS auction manager is typically 25 basis points
7 (annualized) of the ARS amount that CGMI sold to its clients.

8 17. If CGMI was either a sole or co-manager for an ARS, it may also have been designated as
9 the lead or senior manager for the entire offering or for specific tranches of the ARS offering.

10 18. Prior to February 2008, CGMI's practice was to submit cover or support bids in all auctions
11 for which it was the lead broker-dealer.

12 19. CGMI placed support bids to: (1) prevent failed auctions and (2) prevent an auction from
13 clearing at a rate that CGMI believed did not reflect the market for the particular ARS being
14 auctioned.

15 20. For auctions where CGMI was designated a lead manager, it regularly placed support bids
16 for the entire amount of ARS for which CGMI was designated the lead. These support bids
17 ensured that there were enough buyers for every ARS available for sale at the auctions, and as a
18 result, the auctions would not fail.

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20 **Marketing and Listing of ARS**

21 21. Prior to the 2008 Auction Failures, CGMI marketed the following statement to its clients:
22 "To date, CGMI, as lead manager, has never been involved in a failed auction."
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1 22. CGMI and CGMI personnel marketed and sold ARS to investors in Wisconsin as money-
2 market alternatives, cash equivalents, and/or liquid investments.

3 23. From on or about August 30, 2006, to until on or about April 10, 2008, CGMI stated on its
4 website that “[f]rom an investor’s perspective, and subject to the conditions discussed in more
5 detail below [including the risk of a failed auction and liquidity risk], ARS are generally viewed as
6 an alternative to money market funds.”

7 24. ARS are characterized on customer account statements according to the type of security.
8 Until March 2008, CGMI’s account statements listed Preferreds under a heading of “Money market
9 and auction instruments.”

10 25. Since approximately 2004, CGMI has prepared and provided a document titled “Portfolio
11 Review” (also formally called “Private Client Monitor”) to its clients. The Portfolio Review
12 provides a snapshot of client accounts and is a way for CGMI’s clients to review their asset
13 allocations and historical performance.
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15 26. The asset classes under which ARS are listed on the Portfolio Review include: (1) “Cash”
16 (if the ARS reset period is seven days or less, i.e., floaters) and (2) “Cash Equivalents.”

17 27. CGMI did not provide its financial advisers with the training and information necessary to
18 explain adequately ARS products or the mechanics of the auction process to CGMI’s clients.

19 **ARS Market from August 2007 to February 2008**

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21 28. In or about August and September 2007, some ARS auctions managed by other broker-
22 dealers experienced failures (the “2007 Auction Failures”). These failures were primarily based on
23 credit quality concerns related to the ARS at issue.
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1 29. As a result of the 2007 Auction Failures and other market conditions, the ARS market
2 began to see decreases in demand for ARS. Based on the decreasing demand, CGMI accumulated
3 an increasing amount of ARS in its inventory because a higher number of CGMI's support bids
4 were being filled.

5 30. Another effect of the decreasing demand in the ARS market was a general increase in the
6 clearing rates. Given the increase in clearing rates, some ARS issuers contacted CGMI's
7 investment bankers to express their complaints with the cost of their financing and threatened to
8 take future underwriting business to other firms.

9 31. Because of the significant increase in CGMI's ARS inventory, CGMI personnel began to
10 discuss the possibility that there might come a time when CGMI could no longer support the
11 auctions. These discussions started in or about August 2007 and continued until the 2008 Auction
12 Failures. During this time, CGMI understood that its withdrawal from the ARS market would
13 result in some auction failures and the illiquidity of ARS held by its clients.

14 32. Throughout the fall of 2007, CGMI advised some ARS issuers to refinance their ARS into
15 other types of financing such as variable rate demand obligations.

16 33. Despite its advice to ARS issuers, on or about November 8, 2007, CGMI increased the
17 sales credit paid to Smith Barney Financial Advisers in connection with the sale of 7-day
18 Municipal ARS.
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20 34. CGMI's internal reasons for the increased sales credit included: (1) "move increasing
21 inventory"; (2) make "the product more attractive relative to other options"; (3) "greater pressure
22 on our balance sheet"; and (4) "greater pressure from issuers concerning execution versus
23 competitors."
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