

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 08-42
CITIGROUP GLOBAL MARKETS, INC.
MEMBER ORGANIZATION

August 8, 2008

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Violated NYSE Rule 92(a) by entering order to buy (sell) NYSE-listed security while knowingly in possession of customer order to buy (sell) such security, which could be executed at same price; violated NYSE Rule 401 by failing to adequately document customer's trade-along permission, which is required by NYSE Rule 92(b); violated NYSE Rule 132B by failing to record, maintain and preserve certain order tracking information with respect to certain orders originated, received, transmitted, modified and/or cancelled by Firm in NYSE's Order Tracking System format; violated NYSE Rule 132C by failing to transmit order tracking information with respect to certain orders originated, received, transmitted, modified and/or cancelled by Firm in NYSE's Order Tracking System format; violated NYSE Rule 342 by failing to reasonably supervise and implement adequate controls, including separate system of follow-up and review, reasonably designed to achieve compliance with NYSE rules and policies regarding documentation of customers' permission to trade along with or ahead of their orders; and recording, maintenance and transmission of order tracking information in proper electronic Order Tracking System format – Consent to censure and \$235,000 fine.

Appearances:

For the Division of Enforcement
Kenneth R. Bozza, Esq.
Thomas C. Bruno, Esq.
Michael W. Bautz, Esq.
Elizabeth Cochrane
Dan Kane

For Respondent
Barry W. Rashkover, Esq.
Matthew S. Ferguson, Esq.

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A Hearing Officer on behalf of the New York Stock Exchange LLC ("NYSE") considered a Stipulation of Facts and Consent to Penalty entered into between NYSE Regulation, Inc.'s Division of Enforcement ("Enforcement") and Citigroup Global Markets, Inc. ("Respondent" or "Citigroup"), an NYSE member organization. Without admitting or denying guilt, Respondent consented to a finding by a Hearing Officer that it:

- I. Violated NYSE Rule 92(a) by entering an order to buy (sell) an NYSE-listed security, on 11 occasions, while knowingly in possession of a customer order to buy (sell) such security, which could be executed at the same price.
- II. Violated NYSE Rule 401 by failing to conduct its business affairs in accordance with principles of good business practice in that it failed, on 14 occasions, to adequately document a customer's trade along permission, which is required by NYSE Rule 92(b).
- III. Violated NYSE Rule 132B by failing to record, maintain and preserve certain order tracking information with respect to certain orders originated, received, transmitted, modified and/or cancelled by the Firm in various NYSE-listed securities in the NYSE's Order Tracking System format.
- IV. Violated NYSE Rule 132C by failing to transmit to the NYSE certain order tracking information with respect to certain orders originated, received, transmitted, modified and/or cancelled by the Firm in various NYSE-listed securities in the NYSE's Order Tracking System format.
- V. Violated NYSE Rule 342 by failing to reasonably supervise and implement adequate controls, including a separate system of follow-up and review, reasonably designed to achieve compliance with NYSE rules and policies regarding:
 - a. the documentation of customers' permission to trade along with or ahead of their orders; and
 - b. the recording, maintenance and transmission of order tracking information in NYSE-listed securities in the proper electronic Order Tracking System format.

For the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or findings referred to in the Stipulation of Facts and Consent to Penalty, Respondent stipulates to certain facts, the substance of which follows:*

Background and Jurisdiction

1. Citigroup, a member organization, is a registered broker-dealer that provides services including investment banking, underwriting debt and equity securities and advising corporations, governments and institutions, as well as acting as a full-service global broker-dealer engaged in, among other things, retail brokerage of stocks.

* Hearing Officer Note: The facts, allegations, and conclusions contained in paragraphs 1 to 43 are taken from the executed Stipulation of Facts and Consent to Penalty between Enforcement and Respondent. No changes have been made to the stipulated paragraphs by the Hearing Officer, except that pseudonyms have been provided to protect the privacy of non-parties.

2. Enforcement commenced this investigation as the result of a referral from NYSE Regulation's Division of Market Surveillance ("MKS"). By letter dated April 6, 2006, Enforcement notified the Firm that it was investigating potential violations related to the transmission and execution of certain customer and proprietary orders on the Floor of the NYSE. Thereafter, Enforcement received several related additional referrals.
3. By letter dated March 8, 2008, the Firm was notified by Enforcement that it had received from MKS, and was investigating, a referral concerning potential violations related to the Firm's failure to maintain certain trading data and records in the proper electronic "Order Tracking System" (OTS) format.

Overview

4. During the period from January 2004 through November 2006 (the "First Relevant Period"), the Firm, on 11 occasions, entered proprietary trades ahead of, or along with, customer orders in violation of NYSE Rule 92(a). In all but one of these cases, the Firm either did not obtain customer permission from institutional customers, or did not properly follow the provisions of customer permission as documented, to fit within a trading exception under NYSE Rule 92(b). During that same period, the Firm, on 14 occasions, failed to document whether it had received permission from customers for it to trade ahead of, or along with, the customers' orders in violation of NYSE Rule 401. In addition, the Firm failed, in violation of NYSE Rule 342, to reasonably supervise and implement adequate controls reasonably designed to achieve compliance with NYSE rules and policies regarding the documentation of customers' permission to trade along with or ahead of their orders.
5. Moreover, from February 1, 2007 through October 31, 2007 (the "Second Relevant Period"), the Firm failed to properly record, maintain and preserve certain data elements with respect to orders in various NYSE securities and failed to transmit such data elements, at NYSE Regulation's request, in the OTS format in violation of NYSE Rules 132B and 132C. In addition, the Firm failed, in violation of NYSE Rule 342, to reasonably supervise and implement adequate controls reasonably designed to achieve compliance with NYSE rules and policies regarding the recording, maintenance and transmission of order tracking information in NYSE-listed securities in the proper electronic Order Tracking System format.

NYSE Rule 92

6. NYSE Rule 92 generally prohibits members and member organizations from trading on a principal or proprietary basis ahead of ("trading ahead"), or along with ("trading along"), customer orders that are executable at the same price as the principal or proprietary order.¹

¹ A violation of NYSE Rule 92 for "trading along" can occur either when: 1) without receiving express permission from the customer, a member or member organization allocates a portion of a particular execution to both a principal or proprietary order and a customer order; or 2) having received the express

7. In particular, NYSE Rule 92(a) provides that “no member or member organization shall cause the entry of an order to buy (sell) any [NYSE]-listed security for any account in which such member or member organization or any approved person thereof is directly or indirectly interested (a ‘proprietary order’), if the person responsible for the entry of such order has knowledge of any particular unexecuted customer’s order to buy (sell) such security which could be executed at the same price.”
8. NYSE Rule 92(b) contains, among other things, several exceptions that make it permissible for a member or member organization to enter a proprietary order while representing a customer order that could be executed at the same price, “provided the customer’s order is not for the account of an individual investor, and the customer has given express permission, including an understanding of the relative price and size of allocated execution reports....” These exceptions include proprietary orders in which the member or member organization is either: (1) liquidating a position held in a proprietary facilitation account; (2) creating a bona fide hedge; (3) modifying an existing hedge; or (4) engaging in a bona fide arbitrage or risk arbitrage transaction.
9. Information Memos 01-21 (August 9, 2001) and 01-33 (October 8, 2001) provided that “[t]he express permission of the customer must include an understanding by the customer of the relative price and size of allocated execution reports” and that “[s]uch permission must be obtained on an order-by-order basis” as “[m]ember organizations may not rely on a broad contractual understanding with a customer in this regard.” Additionally, these Information Memos stated that “members and member organizations must implement appropriate procedures to capture this information with respect to each such order. The burden of proof to demonstrate that customer consent was obtained will fall on the member or member organization.”²

Violations of NYSE Rule 92(a)

10. On 11 occasions during the First Relevant Period, the Firm entered proprietary trades ahead of and/or traded along with customer orders in violation of NYSE Rule 92(a).

Trading Ahead and/or Trading Along Without Customer Permission

11. In five instances, the Firm traded ahead of and/or along with customer orders. In one instance, the Rule 92(b) exception was not applicable. In the other four instances, the

permission from the customer, a member or member organization allocates portions of a particular execution to both a principal or proprietary order and a customer order in sizes other than that consented to by the customer.

² Subsequent to the events described herein, the NYSE amended Rule 92 on July 5, 2007, to provide that the consent of the customer does not have to be provided on an order-by-order basis, as was the case during the First Relevant Period, provided that the broker-dealer obtains and documents a customer’s affirmative blanket consent and complies with other requirements. Broker-dealers can still obtain consent on an order-by-order basis using pre-amendment express consent procedures.

Firm failed to obtain and document the permission of institutional customers in violation of NYSE Rule 92(a).

XYZ –October 25, 2005

12. For example, on October 25, 2005 at 3:56:02 p.m., the Firm improperly allocated certain executions in stock symbol XYZ to a proprietary order ahead of an institutional customer order without customer permission. The Firm mistakenly believed that the customer order could not be executed. This did not result in any disadvantage to the customer order as the executions the customer order received were at a better price than the proprietary order.

ABC –July 30, 2004

13. On July 30, 2004 from approximately 10:20:05 a.m. to approximately 12:03:55 p.m., the Firm improperly allocated certain executions for the sale of ABC to a proprietary order ahead of an institutional customer order without customer permission. Moreover, the Firm improperly traded along with that customer's order without customer permission by allocating executions for the sale of ABC equally between the proprietary order and the customer's order. In this instance, the customer order, which was filled at a total price of approximately \$2.328 million, was disadvantaged in the amount of approximately \$7,300. The Firm has offered to reimburse the customer for this amount.

Trading Outside of the Documented Customer Permission

14. In six instances, the Firm obtained and documented permission it received from institutional customers to trade along with the customers' orders, but allocated certain executions between the proprietary account and the customers' accounts in amounts different from the permission granted by the customers, in violation of NYSE Rule 92(a). In these instances, the Firm did not obtain the customers' agreement to modify the terms of its original permission to trade along.

DEF –April 5, 2005

15. For example, on April 5, 2005 at approximately 9:08:33 a.m. the Firm received an order to sell 200,000 shares of DEF from an institutional customer. At the time it received the order, the Firm obtained and documented the customer's permission to trade along and share executions equally (i.e., for each execution 50% to the proprietary order and 50% to the customer order).
16. From 10:06:41 a.m. to 11:02:43 a.m., the Firm erroneously allocated certain executions to three different proprietary orders ahead of the customer's order instead of splitting the allocations equally. Then, at 12:07:38 the Firm traded along with the customer, but inadvertently allocated more than 50% of the execution report to a proprietary order. In some of the instances, the customer received an inferior price and the customer order, which was filled at a total price of approximately \$3.348

million, was disadvantaged in the amount of approximately \$3,900. The Firm has offered to reimburse the customer for this amount.

GHI –December 22, 2005

17. On December 22, 2005 at approximately 10:14:53 a.m., the Firm received an order to sell 2,105,000 shares of GHI from an institutional customer. At 10:47:45 a.m., the Firm obtained and documented the customer's permission to trade along and to share executions equally.
18. From 11:51:36 a.m. to 11:52:31 a.m., the Firm erroneously allocated all executions to a proprietary order instead of splitting the allocations equally between the proprietary order and the customer order. This did not result in any disadvantage to the customer order as the executions the customer received were at a better price than the proprietary order.

Failure to Document Customer Permission or a Change in Customer Permission

19. NYSE Rule 401 states, in relevant part, that “[e]very member, allied member and member organization shall at all times adhere to the principles of good business practice in the conduct of his or its business affairs.”

Failure to Document Permission

20. During the First Relevant Period, the Firm on eight occasions failed to document whether it had obtained permission from institutional customers for it to trade along with the customers' orders pursuant to NYSE Rule 92(b) and its own written procedures.
21. For example, on January 13, 2006 in stock JKL, the Firm's trader traded a proprietary order along with an institutional customer's order splitting the executions evenly between the Firm and the customer's order, with each receiving the same price. The Firm states that it had obtained permission from that customer to trade along. The trader, however, failed to record whether he had obtained the customer's permission to trade along.

Failure to Document a Change in the Customer's Permission

22. In six other instances, the Firm obtained and documented permission it received from institutional customers to trade along with the customers' orders, but failed to document modifications of the customers' permission.
23. For instance, on October 3, 2006 at approximately 9:28:09 a.m., the Firm received a customer order to sell 375,000 shares of MNO, which was later modified to sell 2,555,500 shares.
24. At 10:09:08 a.m., the Firm entered a proprietary order to sell 100,000 shares of MNO. Prior to executing the proprietary order the Firm obtained and documented the

customer's permission to trade along with the customer's order, agreeing to split each execution equally.

25. From 10:18:13 a.m. to 10:18:26 a.m., the Firm split 24 executions equally with the customer.
26. From 10:19:11 a.m. to 10:26:44, however, the Firm sold 56,300 shares of MNO, allocating all shares to its proprietary order. The Firm states that it had obtained permission from the customer to trade ahead of the customer's order on these occasions. The trader, however, failed to record whether he had, in fact, obtained the customer's permission to trade ahead on these executions.
27. In each of these 14 instances, the Firm relied upon the NYSE Rule 92(b) exception to NYSE Rule 92(a). To demonstrate that it had complied with the Rule 92(b) exception, good business practice would require that the Firm contemporaneously document that it had obtained its customer's permission. By failing to do so, the Firm violated NYSE Rule 401.

Order Tracking System

28. NYSE Rule 132B requires members and member organizations to immediately record certain data elements (e.g. order identifier, symbol, number of shares, type of order, date/time of expiration, type of account) relative to any order received or originated by such member or member organization, transmitted to, or received from, another member or is transmitted to another department of the same member, or is modified or cancelled.
29. NYSE Rule 132B further requires members and member organizations to maintain and preserve such data for the period of time and accessibility specified in Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-4(b) thereunder, in such electronic form as the NYSE shall from time to time prescribe.³
30. NYSE Rule 132C requires members and member organizations to transmit to the NYSE, in such format as the NYSE may prescribe, such order tracking information as the NYSE may request.
31. The NYSE has prescribed that this information be kept in an Order Tracking System ("OTS") format and that it may request this information on an as-needed basis in order to carry out its critical surveillance and regulatory functions and responsibilities.
32. By letter dated November 8, 2007, the MKS Trading Examination Unit ("TEU"), as part of a review of the Firm's Rule 92 trading practices, requested that the Firm provide it with electronic copies of all open customer orders and all trades executed

³ See also NYSE Information Memos 02-28 (July 1, 2002) and 03-26 (June 10, 2003). The technical specifications for making, maintaining, preserving and transmitting the data is set forth in NYSE Information Memo 04-29 (June 10, 2004).

by the Firm during the Second Relevant Period in OTS format through the NYSE Filing Platform.

33. The Firm was unable to respond to TEU's request and provide the requested data in OTS format because the OTS query it used to collect the relevant trade data elements failed to capture trade data generated from certain trading systems. More specifically, while the data source used to store OTS information was originally compliant with NYSE OTS requirements, the Firm failed to update it to account for changes made to existing trading systems. As a result, not all transactions were captured and the Firm could not provide a complete response to TEU's request in OTS format.
34. However, the Firm did provide hard copies of its trading records to TEU that enabled TEU to manually, and in a time consuming manner, complete its Rule 92 review, which did not disclose any further violations of NYSE Rule 92.
35. By failing to record, maintain and preserve certain order tracking information in the OTS format with respect to certain orders, the Firm violated NYSE Rule 132B.
36. By failing to transmit to the NYSE certain order tracking information in the OTS format with respect to certain orders, the Firm violated NYSE Rule 132C.

Failure to Supervise

37. NYSE Rule 342(a) provides, in pertinent part that: "[e]ach office, department or business activity of a ...member organization ... shall be under the supervision and control of the...member organization establishing it and of the personnel delegated such authority and responsibility."
38. NYSE Rule 342(b)(1) provides, in pertinent part, that the "general partners or directors of each member organization shall provide for appropriate supervisory control and shall [through a general partner or principal executive officer]. . . delegate . . . responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control." NYSE Rule 342(b)(2) further requires that each member organization "establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised."
39. With respect to the supervision of NYSE Rule 92, although the Firm had in place policies and procedures throughout the First Relevant Period that prohibited trading ahead of, or along with, a customer order without express permission of the customer, as well as trading platform functionality to alert traders of the need to obtain Rule 92(b) customer consent at certain times, the Firm failed to have in place a reasonable means of detecting and reviewing whether permission had been obtained and documented, as well as, whether executions were allocated in accordance with the customer's permission. The failure to implement an adequate system of follow-up and review for compliance with NYSE Rule 92 was in violation of NYSE Rule 342.

40. Additionally, with respect to OTS, the Firm's supervisory systems did not provide for supervision reasonably designed to achieve continued compliance, *i.e.*, periodic follow-up reviews by compliance personnel to ascertain that the Firm was complying with OTS data entry requirements and with NYSE rules and policies with respect to the recording, maintenance and transmission of the details of orders in NYSE-listed securities in the proper electronic OTS format.

Other Factors Considered

41. In determining to resolve this matter on the basis set forth herein, Enforcement took into consideration the fact that the Firm has implemented new systems enhancements and controls designed to prevent and detect the types of violations of NYSE Rules 92 and 401 described herein.
42. In addition, the Firm has offered remuneration to all customers disadvantaged by the Firm's aforementioned violations of NYSE Rule 92.
43. Moreover, the Firm has updated its systems and procedures to ensure that its OTS data source captures all relevant information.

DECISION

The Hearing Officer, in accepting the Stipulation of Facts and Consent to Penalty, found that Respondent committed the offenses as set forth above.

PENALTY

In view of the above findings, the Hearing Officer, imposed the penalty consented to by Respondent of a censure and a \$235,000 fine.

For the Hearing Board

Peggy Kuo - Chief Hearing Officer