

**STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT**

IN THE MATTER OF:)

Citigroup Global Markets Inc.)

File Number: 08-00239

Respondent.)

NOTICE OF HEARING

TO THE RESPONDENT: Citigroup Global Markets Inc.
 388 Greenwich Steet
 New York, NY 10013

You are hereby notified that, pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act") and 14 Ill. Adm. Code 130, Subpart K (the "Rules"), a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on the 9th day of March, 2011, at the hour of 10:00 a.m., or as soon thereafter as counsel may be heard, before James L. Kopecky, or another duly designated Hearing Officer of the Secretary of State.

This hearing will be held to determine whether an Order shall be entered against the Respondent in the State of Illinois and/or grant such other relief as may be authorized under the Act including but not limited to imposition of a monetary fine in the maximum amount pursuant to Section 11.E(4) of the Act, payable within ten (10) business days of the entry of the Order.

The grounds for such proposed action are as follows:

Auction Rate Securities

1. Citigroup Global Markets Inc. (“CGMI”) (which includes Smith Barney, a division of CGMI) has engaged in the sale of ARS in the state of Illinois.
2. ARS as a general term refers to long-term debt or equity instruments tied to short-term interest rates that are reset periodically through an auction process.
3. An ARS auction is regarded as a “fail” or “failed auction” if there is not a buyer available for every ARS being offered for sale at the auction. In the event of a failed auction, the investors that wished to sell their ARS were unable to do so and would continue to hold the ARS and wait until the next successful auction to liquidate their positions.
4. Beginning in February 2008, the ARS market experienced widespread failed auctions (the “2008 Auction Failures”).
5. Common categories of ARS instruments include: auction preferred shares of closed-end funds (“Preferreds”); municipal auction rate certificates (“Municipal ARS”); and student loan-backed auction rate certificates (“Student Loan ARS”). The interest rates paid to ARS holders are intended to be set through a Dutch auction process.
6. The interest rate set at an ARS auction is commonly referred to as the “clearing rate.”
7. In order to determine the clearing rate, the buy bids are arranged from lowest to highest interest rate (subject to any applicable minimum interest rate). The clearing rate is the lowest interest rate at which all ARS available for sale at the auction can be sold at par value.

CGMI's Activities in the ARS Market

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

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

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

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

12. The cost of the financing to issuers is directly related to the clearing rates set at the auctions for the issuer's ARS. As an underwriter, CGMI had an interest in providing low-cost financing to the issuers of the ARS that it underwrote because its ability to provide low-cost financing affected the possibility of additional underwriting business.

13. CGMI typically served as a manager of ARS auctions. CGMI's roles for each auction were typically set forth in a broker-dealer agreement entered into between CGMI and the ARS issuer.

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

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

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

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

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

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

Marketing and Listing of ARS

20. Prior to the 2008 Auction Failures, CGMI marketed the following statement to its clients: "To date, CGMI, as lead manager, has never been involved in a failed auction."

21. CGMI and CGMI personnel marketed and sold ARS to investors in Illinois as money-market alternatives, cash equivalents, and/or liquid investments.

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

23. ARS are characterized on customer account statements according to the type of security. Until March 2008, CGMI's account statements listed Preferreds under a heading of "Money market and auction instruments."

24. Since approximately 2004, CGMI has prepared and provided a document titled "Portfolio Review" (also formally called "Private Client Monitor") to its clients. The Portfolio Review provides a snapshot of client accounts and is a way for CGMI's clients to review their asset allocations and historical performance.

25. The asset classes under which ARS are listed on the Portfolio Review include: (1) "Cash" (if the ARS reset period is seven days or less, i.e., floaters) and (2) "Cash Equivalents."

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

ARS Market from August 2007 to February 2008

27. In or about August and September 2007, some ARS auctions managed by other broker-dealers experienced failures (the "2007 Auction Failures"). These failures were primarily based on credit quality concerns related to the ARS at issue.

28. As a result of the 2007 Auction Failures and other market conditions, the ARS market began to see decreases in demand for ARS. Based on the decreasing demand, CGMI accumulated an increasing amount of ARS in its inventory because a higher number of CGMI's support bids were being filled.

29. Another effect of the decreasing demand in the ARS market was a general increase in the clearing rates. Given the increase in clearing rates, some ARS issuers

contacted CGMI's investment bankers to express their complaints with the cost of their financing and threatened to take future underwriting business to other firms.

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

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

32. Despite its advice to ARS issuers, on or about November 8, 2007, CGMI increased the sales credit paid to Smith Barney Financial Advisers in connection with the sale of 7-day Municipal ARS.

33. CGMI's internal reasons for the increased sales credit included: (1) "move increasing inventory"; (2) make "the product more attractive relative to other options"; (3) "greater pressure on our balance sheet"; and (4) "greater pressure from issuers concerning execution versus competitors."

34. On February 11, 2008, CGMI did not place any support bids in auctions for Student Loan ARS. As a result, on that date all of the Student Loan ARS auctions where CGMI was designated the lead manager failed.

35. After February 11, 2008, CGMI no longer continued to place support bids on all ARS for which it was designated the lead manager. Subsequently, many auctions then failed, resulting in the illiquidity of billions of dollars invested in ARS.

Auction Desk Tapes

36. CGMI recorded the Auction Desk's phone calls. These calls sometimes included conversations with issuers, other CGMI personnel, and institutional investor clients.

37. After a tape was fully recorded, it would be catalogued and maintained for a period of ninety (90) days. Following this 90-day period, the tape would be placed in a pool of tapes available for re-recording. CGMI represents that recycled tapes were randomly selected from the available pool for re-recording.

38. On or about April 17, 2008, the Texas State Securities Board ("TSSB") requested documentary evidence related to ARS for the period from January 1, 2007 through April 17, 2008, including tape recordings, from CGMI.

39. On or about July 2, 2008, CGMI informed the TSSB that certain tapes of the Auction Desk for the period from mid-October 2007 through February 13, 2008 had been overwritten pursuant to CGMI's represented tape recycling process. Upon discovery of the issue, CGMI promptly requested the suspension of the recycling of the Auction Desk tapes. CGMI represents that it subsequently determined that only one of the nine tapes for the period July 13, 2007 through July 2, 2008 had in fact been overwritten.

40. As of July 2, 2008, CGMI had not overwritten the tapes for the period from July 13, 2007 through December 17, 2007 and for the period from February 14, 2008 through July 2, 2008.

41. CGMI failed to take adequate steps to secure one tape of the Auction Desk.

ALLEGATIONS OF LAW

1. Illinois has jurisdiction over this matter pursuant to the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act").

2. CGMI employed unethical practices in the offer and sale of auction rate securities, subjecting CGMI to sanctions under 8.E (1)(b) of the Act.
3. CGMI failed to reasonably supervise its agents or employees, in violation of Section 8.E (1)(e)(iv) of the Act.

You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130)(the “Rules”), to file an answer, special appearance, or other responsive pleadings to the allegations above within thirty (30) days of the receipt of this Notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.

Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to appear shall constitute a default by you.

A copy of the Rules and Regulations promulgated under the Illinois Securities Law and pertaining to hearings held by the Office of the Secretary of State, Illinois Securities Department, are available at <http://www.ilga.gov/commission/jcar/admincode/014/01400130sections.html>, or upon request.

Delivery of Notice to the designated representative of the Respondent constitutes service upon such Respondent.

Dated: This 22nd day of December, 2010.

A handwritten signature in black ink, appearing to read "Jesse White", with a stylized flourish at the end.

Jesse White
Secretary of State
State of Illinois

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