

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 55712 / May 7, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12629**

**In the Matter of**

**Citigroup Global Markets, Inc., successor by  
merger to Legg Mason Wood Walker Inc.,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE  
PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS  
PURSUANT TO SECTION 15(b)  
OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) against Citigroup Global Markets, Inc., successor by merger to Legg Mason Wood Walker Inc. (“Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“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 it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:<sup>1</sup>

#### A. RESPONDENT

Citigroup Global Markets, Inc., a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, is the successor by merger to Legg Mason Wood Walker Inc. ("LMWW"). LMWW was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act during the relevant period. Thereafter, on December 1, 2005, Citigroup Inc. acquired LMWW and then merged LMWW into its subsidiary, Citigroup Global Markets Inc. Subsequently, a Form BDW was filed with respect to the registration of LMWW, and it was accepted by the Commission on June 6, 2006. Prior to Citigroup Inc.'s acquiring it, LMWW engaged in the conduct described in this Order.

#### B. SUMMARY

As part of its broker-dealer business, LMWW underwrote and managed a limited number of auctions for auction rate securities. From at least January 1, 2003 through June 30, 2004, in connection with certain auctions, LMWW engaged in the practice, described in Section III.C.2 below, that violates Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"). Accordingly, Respondent violated that provision.

#### C. FACTS

##### 1. The Auction Rate Securities Market

Auction rate securities are municipal bonds, corporate bonds, and preferred stocks with interest rates or dividend yields that are periodically re-set through auctions, typically every 7, 14, 28, or 35 days. Auction rate bonds are usually issued with maturities of 30 years, but the maturities can range from 5 years to perpetuity. Auction rate securities are often marketed to issuers as an alternative variable rate financing vehicle, and to investors as an alternative to money market funds. Auction rate securities were first developed in 1984, and the auction rate securities market has grown to well over \$200 billion. Mostly institutional investors participate in the auction rate securities markets, although recently smaller investors also have begun participating in the market. Typically, the minimum investment is \$25,000.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

a. Auction Mechanics. Auction rate securities are auctioned at par so the return on the investment to the investor and the cost of financing to the issuer between auction dates is determined by the interest rate or dividend yield set through the auctions.<sup>2</sup> According to the disclosure documents (the prospectus or official statement) for each security, the interest rate or dividend yield is set through an auction (commonly referred to as a “Dutch” auction) in which bids with successively higher rates are accepted until all of the securities in the auction are sold. Investors can only submit the following types of orders: 1) a “hold” order, which is the default order for current investors (i.e., the order that is entered for a current holder if the holder takes no action), where a current investor will keep the securities at the rate at which the auction clears; 2) a “hold-at-rate” bid, where a current investor will only keep the securities if the clearing rate is at or above the specified rate; 3) a “sell” order, where a current investor will sell the securities regardless of the clearing rate; or 4) a “buy” bid, where a prospective investor, or a current investor who wants more securities, will buy securities if the clearing rate is at or above the specified rate. Disclosure documents often state that an investor’s order is an irrevocable offer.

The final rate at which all of the securities are sold is the “clearing rate” that applies to all of the securities in the auction until the next auction. Bids with the lowest rate and then successively higher rates are accepted until all of the sell orders are filled. The clearing rate is the lowest rate bid sufficient to cover all of the securities for sale in the auction.<sup>3</sup> If there are not enough bids to cover the securities for sale, then the auction fails, the issuer pays an above-market rate set by a pre-determined formula described in the disclosure documents, and all of the current holders continue to hold the securities, with minor exceptions. If all of the current holders of the security elect to hold their positions without bidding a particular rate, then the clearing rate is the all-hold rate, a below-market rate set by a formula described in the disclosure documents.

b. Broker-Dealers’ Role in Auctions. The issuer of each security selects one or more broker-dealers to underwrite the offering and/or manage the auction process. Investors can only submit orders through the selected broker-dealers. The issuer pays an annualized fee to each broker-dealer engaged to manage an auction (typically 25 basis points for the par value of the securities that it manages). The issuer also selects an auction agent to collect the orders and determine the clearing rate for the auction.

Investors must submit orders for an auction to the broker-dealer by a specified time. Many broker-dealers have an internal deadline by which investors must submit their orders to the broker-

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<sup>2</sup> Between auctions, investors might be able to buy or sell auction rate securities in the secondary market at prices greater than, equal to, or less than par.

<sup>3</sup> For example, suppose \$100,000 of securities were for sale and the auction received four buy bids. Bid A was for \$50,000 at 1.10%, Bid B was for \$50,000 at 1.15%, Bid C was for \$50,000 at 1.15%, and Bid D was for \$25,000 at 1.20%. Under these circumstances, the “clearing rate” would be 1.15%, meaning all of the securities in the auction would pay interest at a rate of 1.15% until the next auction. Bid A would be allocated \$50,000, Bids B and C would receive pro-rata allocations (\$25,000 each), and Bid D would receive no allocation.

dealer. This internal deadline allows the broker-dealer sufficient time to process and submit the orders to the auction agent. Other broker-dealers allow investors to submit orders up until the submission deadline, i.e., the deadline for broker-dealers to submit orders to the auction agent. The broker-dealers must submit the orders to the auction agent before the submission deadline, and usually must identify each separate order.

c. Auction Agents' Role in Auctions. After receiving the orders from the broker-dealers, the auction agent calculates the clearing rate that will apply until the next auction. In practice, however, if there is only one broker-dealer, the broker-dealer can discern the clearing rate before submitting the orders to the auction agent.

The auction agent allocates the securities to the broker-dealers based on the orders they submitted. The auction procedures generally state that orders are filled in the following order: hold orders, hold-at-rate and buy bids with a rate below the clearing rate, hold-at-rate orders with a rate at the clearing rate, and buy bids with a rate at the clearing rate. When there are more bids for securities at the clearing rate than securities remaining for sale, the securities are allocated on a pro rata basis first to the hold-at-rate bidders and then to the buy bidders. Generally, the auction procedures require broker-dealers to follow the same hierarchy in allocating the securities to their customers.

d. Disclosures Regarding Broker-Dealer Bidding. During the relevant period, the disclosure documents for different securities varied as to what, if anything, they disclosed about broker-dealers bidding in auctions that they were managing. Some disclosure documents did not disclose anything about bidding by broker-dealers. Other disclosure documents disclosed that broker-dealers may bid in auctions with language similar to the following: “[a] broker-dealer may submit orders in Auctions for its own accounts.” Still other disclosure documents disclosed that broker-dealers may bid in auctions and may have an information advantage with language similar to the following: “[a] Broker-Dealer may submit orders in Auctions for its own accounts. Any Broker-Dealer submitting an order for its own account in any Auction might have an advantage over other bidders in that it would have knowledge of other orders placed through it for that Auction (but it would not have knowledge of orders submitted by other Broker-Dealers, if any).”

## 2. LMWW's Conduct

LMWW intervened in auctions by bidding for its proprietary account to prevent failed auctions without adequate disclosure. Failed auctions occur when there are more securities for sale than there are bids for securities and result in an above-market rate described in the disclosure documents. LMWW submitted bids to ensure that all of the securities would be purchased to avoid failed auctions and thereby, in certain instances, affected the clearing rate.<sup>4</sup>

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<sup>4</sup> The clearing rate determines the interest rate or yield the issuer must pay to investors until the next auction. In those instances when this practice lowered the clearing rate, investors received a lower rate of return on their investments. To the extent that this practice affected the clearing

#### **D. LEGAL SECTION**

Section 17(a)(2) of the Securities Act prohibits material misstatements and omissions in any offer or sale of securities. Negligent conduct can violate Section 17(a)(2). See, e.g., SEC v. Hughes Capital Corp., 124 F.3d 449, 453 (3d Cir. 1997). As a result of LMWW's conduct, Respondent willfully<sup>5</sup> violated Section 17(a)(2) of the Securities Act.

#### **E. THE PENALTY AMOUNT**

The Commission aims to promote voluntary disclosures in industry-wide investigations and to encourage firms to provide comprehensive information to the staff in such investigations. See In the Matter of Bear, Stearns & Co. Inc. et al., Securities Act Release No. 8684 (May, 31, 2006) ("Previous Settlement"). In determining the size of the penalty in this matter, the Commission considered LMWW's cooperation afforded the Commission staff and LMWW's relatively small share of the auction rate securities markets. The Commission, however, also considered that LMWW reported the practice described in Section III.C.2 later than the broker-dealers in the Previous Settlement reported their practices.

#### **IV.**

In view of the foregoing, the Commission deems it appropriate, and in the public interest, to impose the sanctions agreed to in Respondent's Offer. In determining not to seek or order that the Respondent cease and desist from committing or causing any violation and any future violations of Section 17(a)(2) of the Securities Act, the Commission considered that the Respondent already is subject to such an order concerning the same type of misconduct described in this Order. See In the Matter of Bear, Stearns & Co., Inc., Securities Act Release 8684 (May 31, 2006).

Accordingly, pursuant to Section 15(b) of the Exchange Act, it is hereby ORDERED that Respondent:

- A. Be, and hereby is, censured, and
- B. Shall, within 10 days of the entry of this Order, pay a civil money penalty of \$200,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank

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rate, investors may not have been aware of the liquidity and credit risks associated with certain securities.

<sup>5</sup> "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, see Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kenneth R. Lench, Division of Enforcement, Securities and Exchange Commission, 100 F Street N.E., Washington, D.C. 20549-6041.

By the Commission.

Nancy M. Morris  
Secretary