UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------UNFILED----------

U. S. SECURITIES AND EXCHANGE COMMISSION,	**BETTER MARKETS INC.'S BRIEF IN OPPOSITION TO PROPOSED SETTLEMENT**
Plaintiff,	**----------UNFILED----------**
v.	
CITIGROUP GLOBAL MARKETS INC.,	**CIVIL ACTION NO. 1:11-cv-07387-JSR**
Defendant,	**JUDGE JED S. RAKOFF**
	ECF CASE

Better Markets, Inc.'s Brief in Opposition to Proposed Settlement- UNFILED

Better Markets, Inc. ("Better Markets") submits this brief in opposition to the proposed settlement and final judgment (the "Proposed Settlement") between Plaintiff Securities and Exchange Commission ("SEC") and Citigroup Global Markets Inc. (along with certain affiliates, "Citigroup") (collectively, the "Parties").

Introduction

The Proposed Settlement of this $1 billion securities fraud is not fair, adequate, reasonable, or in the public interest, insofar as can be determined by the existing incomplete record. In fact, the Parties' disclosures and the Proposed Settlement are so woefully deficient that it is not possible for this court to find otherwise. However, based on the record that does exist, the Proposed Settlement would reward securities fraud and sends the message that crime pays, as demonstrated in particular by the undisclosed fact that this case is reportedly settling more than $145 billion of Citigroup's CDO deals.

While described by the SEC in its filings in support of the Proposed Settlement as a disclosure case involving misrepresentations and omissions, this case is really about an egregious and highly sophisticated fraud that was designed and executed for one purpose: to enrich Citigroup, its affiliates, officers and employees in innumerable ways, most of which are merely alluded to in Plaintiff's filings. Moreover, viewed in the light of those enrichments plus the other benefits to Citigroup from the Proposed Settlement, the proposed penalties are so trivial as to be meaningless.

Using inside information, Citigroup sold $847 million in notes in a fraudulent deal it specifically designed to fail so that it could make a fortune on the undisclosed $500 million short position it took in the deal at the very same time it was selling the deal to unsuspecting investors. "[A] collection of dogsh!t" and "possibly the best short EVER!" (Citigroup Compl. ¶58) was the reaction of two sophisticated market participants who saw the portfolio of the deal Citigroup was trying to sell to investors. Their reactions would turn out to be gross understatements.

Just as Citigroup planned, the built-to-blow-up deal failed spectacularly within months of closing: not only was it one of the worst-performing deals during the relevant period, it was an award-winning failure: the second-fastest transaction to default ever. The result: all the investors lost virtually everything they invested (not less than $847 million) and Citigroup hit the jackpot with its short plus pocketed tens of millions of dollars in fees and other profits, apparently amounting to something between $600 million and $700 million.

For all this, Citigroup is paying only $285 million in disgorgement, interest and penalties, but only $190 million of that is disgorgement (with interest). However, that amount appears to be only a fraction of the benefits Citigroup and its employees reaped from this fraud. Additionally, the only real penalty the SEC proposes to impose on Citigroup is a $95 million

fine, which is, by virtually any measure, less than trivial to a banking giant like Citigroup, which has $2 trillion in assets and had revenues of more than $20 billion in just the last three months.

Moreover, the $95 million penalty is almost the exact amount of worthless securities Citigroup removed from its proprietary books and sold at inflated prices ($92.25 million) to the soon-to-be-worthless deal it was marketing to unsuspecting investors. Thus, the "penalty" is merely equal to Citigroup's gain from just one sliver of the fraudulent scheme it perpetrated. There is no indication that the SEC took the profits from this secret sale and other significant fraudulent conduct by Citigroup into account when it decided on this paltry penalty.

Also, at the same time this fraudulent built-to-blow-up deal was being marketed and sold to investors, Citigroup agreed to increase the bonus for just one of its involved employees by more than 100% to $2.25 million and to guarantee it. Because the SEC provided virtually no information on any individuals involved in this fraud, it is impossible to know the total bonus payout from this scheme, but it would be reasonable to believe that the total bonuses from this one fraudulent deal substantially exceeded the $95 million "penalty."

Furthermore, these facts relate to only this one deal. The SEC does not mention that Citigroup was a conveyor belt creating, marketing and selling dozens and dozens of similar deals, done by many of the same employees that did this deal. In fact, this deal was only 1of at least 18 CDO deals Citigroup did around the same time. That is not surprising because Citigroup was the world's top issuer of CDOs in 2007, placing almost $50 billion in CDOs that year alone, which was more than 10% of the worldwide total. Citigroup issued more than $110 billion of CDOs in just the three years of 2005, 2006 and 2007 (and more than $145 billion in 2000-2008).

Yet, the SEC makes absolutely no mention of any of those other deals: How were all those deals conducted? Were the same, different or no fraudulent schemes used? What were

Citigroup's profits and how large were the losses for its investors? Is the SEC representing that Citigroup only defrauded the investors in this one scheme and, if so, how could that be?

The answers to these questions are critically important because Citigroup publicly claimed when this settlement was announced on October 19, 2011 that this **one** settlement purportedly for **one** deal in fact ends **all** SEC investigations into **all** of Citigroup's CDO deals, i.e., more than $145 billion in deals. (See Exhibit A hereto) The SEC did not deny Citigroup's statement. Thus, although not disclosed to this Court, the Proposed Settlement isn't a settlement of a single $1 billion deal, but is a settlement of innumerable CDO deals that placed more than $145 billion in CDOs, according to Citigroup.

Furthermore, the SEC has sanctioned this very Defendant 5 times in the last 8 years for securities fraud violations, all with it being allowed not to admit or deny the allegations (although there is a material exception to this seeming limitation, as discussed below). (See Exhibit B hereto) Thus, Citigroup appears to be a repeat offender that has been repeatedly sanctioned to no effect. If so, how could this Proposed Settlement possibly be fair, adequate, reasonable or in the public interest and why weren't those facts brought to the attention of the court by the Parties?

That question highlights another gross deficiency in this Proposed Settlement: as evidenced by this Court's Order dated October 27, 2011, the Parties have provided this Court with shockingly little factual information or legal support for the Proposed Settlement. Indeed, the SEC's entire Memorandum in Support of Proposed Settlement is only 7 double-spaced pages long, including the caption.[1] ("SEC Memo") Conclusory statements that amount to little more than "trust us" and "apply rubber stamp of approval here" are a grossly inadequate basis for a

[1] Tellingly, the SEC's press release trumpeting the settlement would have been longer than this Memo if it had been double-spaced. (Transmittal Affidavit Exhibit 1, "TA Ex. 1")

court to evaluate, much less approve, the Proposed Settlement, which should be rejected on this ground alone.[2]

It is as inexplicable as it is inexcusable for the SEC to have provided such minimal information regarding this case, although one reason may be that the SEC simply doesn't know the information because, in this massive case, **it took testimony from only "several current and former [Citigroup] employees."** (Citigroup Nov. 7 Memo. p. 4, emphasis added) The only way this court could possibly have sufficient information to determine whether or not the Proposed Settlement is fair, adequate, reasonable or in the public interest is for the Court to require the disclosure of the information necessary for this court to discharge its duty, which is not to merely rubber-stamp a settlement just because the SEC says to.[3]

[2] The Court's Order of October 27, 2011, identifying questions to be answered by the Parties conclusively makes this point. No court should have to issue an order to obtain such basic and essential information that any court would need to adequately and fairly discharge its duty to evaluate a proposed settlement. Moreover, the Parties responses of November 7, purportedly in response to this Order, provide very little additional information and are largely evasive and unresponsive. Indeed, rather than fully comply with the Order, the SEC used its filing largely to argue that this court has such a limited role that it should stop asking questions and just approved the Proposed Settlement. Similarly, Citigroup used its filing largely to argue its innocence, the sophistication of its investor victims and to selectively introduce and spin cherry-picked exculpatory information that isn't in the record before the court.

[3] This would in no way be the same as or even come close to adjudicating the case on the merits; nor would it be this Court overstepping its prescribed role, as the Parties claim in their November 7 responses to the court's October 27 Order. Indeed, it is the only way the Court can discharge its role, which is not to blindly accept the SEC's refusal to disclose critical information.

Citigroup's Fraudulent Conduct[4]

While the structure of the transaction at issue in this case and the technical jargon used to describe it are complex, Citigroup's conduct is not: it involves a series of lies designed to deceive investors into buying worthless or soon-to-be-worthless derivatives and to also deceive a seller of credit protection. This was all done for the sole purpose of enriching Citigroup. And, while the transaction at issue involves complex derivatives (including CDOs,[5] CDSs and all sorts of complicated financial instruments, terms and structures), they are all used merely as the vehicle to perpetrate the securities fraud and enable Citigroup to reap hundreds of millions of dollars of illicit gains. (While the SEC refers to this transaction as "Class V III" in its filings, it is referred to herein as the descriptively accurate "CDO Sell & Short Scheme.")

The CDO Sell & Short Scheme arose from Citigroup's desire to profit from a virtually guaranteed bet by using inside information (about the real value of securities on its books, about securities it had recently sold in other deals and other market information it was privy to). By mid to late 2006, Citigroup knew that many of its housing-based derivatives that were "unsold" from its prior deals (and therefore were on its own proprietary books) were worthless, increasingly worthless or likely to become worthless. Citigroup was looking at substantial losses from these derivatives so it began to figure out how to move those derivatives and losses off its books by selling them to unsuspecting investors.

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[4] Because there is so little information about Citigroup's fraud in the few filings in this case, this memo also refers to the filings in the SEC's related matters: SEC v. Brian Stoker, 11 Civ 7388 ("SEC Stoker Compl.") (Ex. 2 to the Transmittal Affidavit of Dennis M. Kelleher, "TA Ex. 2") and the SEC administrative proceedings and settlement In re Credit Suisse Alternative Capital LLC (f/k/a Credit Suisse Alternative Capital, Inc.), Credit Suisse Asset Management, LLC, and Samir H. Bhatt, Rel. No. 9268 ("SEC CSAC C&D") (TA Ex. 3)

[5] Unless otherwise defined herein, defined terms are used as defined in the Citigroup Complaint ("Citigroup Compl.").

Doing that would provide Citigroup with significant profits from (1) not having to mark down the "unsold" derivatives on its books, (2) profiting from their sales, at grossly inflated prices no less, and (3) receiving fee income from the deals. But, even all that wasn't enough enrichment for Citigroup. To obtain enormous profits from selling worthless or soon-to-be worthless securities, Citigroup also wanted to short the very derivative securities it was structuring, marketing and selling to investors.

Thus, Citigroup's desire to score big on shorting a specific group of derivatives that it knew were worthless or would soon be worthless, was the motivation for the CDO Sell & Short Scheme that is the subject of this action. Citigroup's problem, however, was that to short those derivatives required finding investors to first buy them (or synthetics of them), which required finding investors to buy something that was virtually worthless or certain to become totally worthless in a very short period of time. The "solution" to that problem was the fraud that made the CDO Sell & Short Scheme possible.

Citigroup's extensive fraudulent conduct, as can be determined from the SEC's filings, including the planning, structuring, marketing, selling and shorting of the CDO Sell & Short Scheme, is too lengthy to be detailed here. It is summarized in **Exhibit C** attached hereto.

However, some of the more egregious conduct included using a well-known, brand-name entity to be the representative of prospective investors, but who would lie about its role and help Citigroup defraud the investors. This was essential to the entire CDO Sell & Short Scheme. Citigroup got Credit Suisse Alternative Capital LLC ("CSAC" or "Investor Representative") to play this role.[6] See SEC Stoker Compl. ¶ 11, TA Ex. 2; SEC CSAC C&D, Ex. 3.

[6] Given the essential, knowing and extensive involvement of CSAC as the purported investor representative, it is odd not to see a claim for conspiracy, RICO or other similar types of claims.

Also, Citigroup wasn't satisfied with just putting together a built-to-blow-up deal and shorting $500 million of it. It seems to have figured out how to defraud the investors in as many ways as possible in addition to the $500 million short. For example, Citigroup got the Investor Representative to buy worthless or virtually worthless "unsold" bonds on its proprietary books at the inflated price of $92.25 million, thereby overcharging the investors. Ultimately, these bonds constituted more than 10% of the entire CDO Sell & Short Scheme's investment portfolio. (SEC CSAC C&D ¶4, TA Ex. 3) Another example is Citigroup bought the $500 million short at below market rates, thereby underpaying the investors.

Interestingly, the SEC never clearly detailed or summarized Citigroup's fraudulent conduct in the Citigroup Complaint. However, it did so in the complaint it filed in a related action against former Citigroup employee Brain H. Stoker[7] where it said:

> "In sum, while ostensibly acting in its customary role as arranger of a CDO intended to benefit the CDO's investors, Citigroup in fact used [the CDO Sell & Short Scheme] as a proprietary trade, whereby it furthered its own economic interests, which were directly adverse to those of [the CDO Sell & Short Scheme's] investors, without disclosing its role in the selection of assets or the short position it took with respect to those assets." (SEC Stoker Compl. ¶ 3,TA Ex. 2)

As Citigroup planned, the entire $1 billion CDO Sell & Short Scheme became worthless in a matter of months after the deal closed. In fact, within four months approximately 25% of the assets in the deal were put on negative watch by one or more rating agency. (Citigroup Compl. ¶59) Not surprisingly, the derivatives Citigroup sold, selected, referenced and shorted did significantly worse than the other derivatives in the deal. (Id. ¶¶ 59-60) In merely 8 months

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For the same reason, it should be ascertained if there was a criminal referral regarding this matter.

[7] The SEC is charging Mr. Stoker, "a Director in the CDO structuring group at Citigroup" (SEC Stoker Compl. ¶9) with violating the law by, among other things, "engaging in a course of business that operated as a fraud upon investors in" the CDO Sell & Short Scheme (Id. ¶7), something not mentioned in the complaint filed and settled against Mr. Stoker's employer, Citigroup.

after the deal closed, "every" tranche in the CDO Sell & Short Scheme was downgraded and, on November 19, 2007, the entire deal "was declared to be an Event of Default." (Id. ¶ 61)

Thus, the CDO Sell & Short Scheme Citigroup constructed to quickly become worthless and to be a guaranteed payoff for itself at the expense of its clients happened just as planned. The fraudulent scheme worked perfectly: the investors lost everything (as detailed below) and Citigroup made a fortune (also as detailed below).

The SEC understates this fact, first in its complaint against Citigroup and then in its complaint against Mr. Stoker:

> "Citigroup knew that representing to investors that an experienced, third-party investment adviser had selected the investment portfolio would facilitate the placement [i.e., sale] of the notes that the CDO-squared would issue." (Citigroup Compl. ¶20, emphasis added)
>
> "Citigroup knew it would be difficult to place [i.e., sell] the liabilities of a CDO squared if it disclosed to investors its intention to use the vehicle to short a hand-picked set of CDOs and to buy Citigroup's hard-to-sell cash CDOs [actually, almost certainly impossible to sell, which is the only reason they would still be "unsold" on Citigroup's books]." (SEC Stoker Compl. ¶25, emphasis added)

Such fraud didn't "facilitate" such sales. It made them possible. Similarly, it wouldn't have been "difficult" to sell these securities if Citigroup didn't lie about picking and shorting the securities. It would have been impossible. The fraud here didn't help around the edges of the deal. The fraud was the deal and without that fraud there would have been no possibility of a deal. Citigroup knew this precisely, which is why it so carefully and elaborately constructed the fraud.

Citigroup's Enrichment From its Fraud

The filings in the case against Citigroup have almost no specific information about how much Citigroup made from its fraudulent scheme or how much economic damage it did to how many investors.

The Citigroup Complaint states the following incomplete bare bones of the economics of the CDO Sell & Short Scheme:

> "The arranging bank [Citigroup here] for a CDO-squared typically profits from the fees it charges for structuring and marketing the transaction, any fees it receives for intermediating trades, and the spread it captures by buying protection from the CDO-squared and selling protection to its customers." (Citigroup Compl. ¶14)

> "Citigroup was paid approximately $34 million in fees from structuring and marketing [the CDO Sell & Short Scheme] and, as a result of its fees and its short positions on $500 million of assets in the [CDO Sell & Short Scheme] investment portfolio, Citigroup realized net profits of approximately $160 million in connection with" the CDO Sell & Short Scheme. (Citigroup Compl. ¶63, emphasis added)

The SEC states that "Citigroup realized net profits of at least $160 million" from the CDO Sell & Short Scheme. (Memo. p. 6, emphasis added) It is inexplicable why the precise amounts made and booked by Citigroup are not disclosed or why there isn't a full accounting of all the direct and indirect remuneration that came in and went out to/from Citigroup and the Investor Representative. There is simply no justification for not disclosing those precise numbers or for citing approximate numbers.

There is also no justification for merely providing the so-called "net profits" Citigroup allegedly made. All the profits from any source and in any amount connected in any way to the CDO Sell & Short Scheme should be required to be disclosed. If Citigroup claims that those amounts should be offset for some reason (i.e., premiums paid on the CDS before it paid out), then those amounts and the specific, detailed basis for any such claimed offset should also be spelled out.

Given that Citigroup's primary purpose for the CDO Sell & Short Scheme was the $500 million short position, there is no defensible basis for not detailing the economics of that most of all, particularly because the short was in the money in a matter of mere months. As stated in the Citigroup Complaint, "The protection seller promises to pay the protection buyer if the reference

asset experiences a 'credit event,' such as a default." (Citigroup Compl. ¶11) An "Event of Default" was declared on November 19, 2007. (Citigroup ¶61) While there is mention of Ambac as the seller of the $500 million credit protection to Citigroup and there is mention that BNP would have to pay Citigroup for the credit protection if Ambac could not (Citigroup Compl. ¶¶ 49-52), there is no mention of how much credit protection was paid to Citigroup or by whom, but presumably Citigroup was paid $500 million.

As best as can be determined from what information the SEC did disclosed, this is what appears to have been the benefits to Citigroup from its fraudulent CDO Sell & Short Scheme:

1. It removed $92.25 million face value of worthless or near worthless unsold CDOs from its own books;
2. It sold them to the deal through the Investor Representative, who did little or no due diligence, at inflated non-market prices;
3. It thereby took money out of the very deal it was structuring by causing the investors to over-pay for the collateral Citigroup sold to the deal;
4. It thereby removed some of the most worthless CDOs from its own proprietary account and booked revenue from the sales;
5. It avoided booking a loss (or a bigger loss) on those unsold CDOs, which might have required it to take a charge which might have negatively impacted its stock price (which would have happened no later than 8 months later when the "event of default" occured);
6. It could then use those CDO "sale" prices to maintain inflated prices on other similar, comparable or fair valued derivatives on its books and the books of others to whom it sold securities and to whom it, by common business practice, still provided pricing or indicative pricing for;
7. All of this enabled Citi to keep its CDO machine pumping out worthless derivatives to unsuspecting clients, all soon to be victims suffering massive losses;
8. It was also allowed to buy $500 million in credit protection at below market rates;
9. It thereby again took money out of the very deal it was structuring by causing investors to be under-paid for the credit protection;
10. It also received fees for its ostensible role as the arranging bank in the deal, apparently in the amount of about $32 million;
11. Its $500 million in credit protection was in the money quickly and therefore it had almost no out-of-pocket premium costs;
12. It received the proceeds from its $500 million short in very little time eliminating risk associated with time and other factors; and
13. While the ultimate default of this deal may have hurt Citigroup's CDO business, until at least then, this sale almost assuredly was used to market and sell other deals.

The SEC may be right when it asserts that "Citigroup realized net profits of approximately $160 million in connection with" the CDO Sell & Short Scheme. (Citigroup Compl. ¶ 63, emphasis added) However, as suggested by the listing above (which is almost certainly incomplete due to the extremely limited information the SEC has made publicly available), that calculation cannot possibly include all the benefits Citigroup intended to and almost certainly did receive from this fraudulent scheme, which appears to be no less than $600 million.

A full, complete and certified accounting of all remuneration and/or benefits of any type or form received directly or indirectly by Citigroup in connection with the CDO Sell & Short Scheme must be ordered, publicly disclosed and evaluated by the Court.

Citigroup's Employees' Enrichment from the Fraudulent Conduct

The only purpose of the CDO Sell & Short Scheme was to make as much money as possible (directly and/or by avoiding as many losses as possible). That was not, of course, the purpose of a nameless and faceless corporation such as Citigroup. It was the purpose of the individuals who conceived, structured, marketed, sold, shorted and executed this entire fraudulent scheme. Those individuals intended to and undoubtedly were abundantly rewarded for their contribution to the revenue and profits generated by this scheme.

Yet, again inexplicably, the filings in the case against Citigroup seem designed to conceal and obscure rather than identify and illuminate who did what in connection with the CDO Sell & Short Scheme. (However, the SEC simply may not know the information because, in this massive case, **it took testimony from only "several current and former [Citigroup] employees."** (Citigroup Nov. 7 Memo. p. 4, emphasis added))

Importantly, Citigroup's fraudulent conduct in connection with the CDO Sell & Short Scheme involved many, many employees and spanned across many parts of the corporation, including the syndicate, trading, structuring, marketing and sales desks, among others.

(Citigroup Compl. ¶ 19) However, not one single name of any individual involved in the CDO Sell & Short Scheme appears anywhere in the filings in the case against Citigroup.[8] The SEC merely referenced an amorphous working area or a person's title:

- "Personnel on Citigroup's CDO syndicate, trading and structuring desks"
- "Managing Director on Citigroup's CDO trading desk"
- "A senior Citigroup CDO structurer"
- "Citigroup's CDO trading group and others"
- "CDO salesperson"
- "Citigroup's Risk Management Organization"
- "the head of Citigroup's DCO syndicate desk"
- "CDO sales group"

Moreover, this minimal disclosure of the titles/positions of those who actually conceived of, planned, structured, marketed and sold the CDO Sell & Short Scheme fails to come close to indicating the innumerable other people and areas at Citigroup who undoubtedly were involved in or aware of the deal. For example, there is no mention of the people from management, legal, risk, compliance, finance and compensation who would typically be involved in or aware of a deal like this, particularly given that it was a proprietary deal with significant profit potential and was a bet against Citigroup's own clients.

Thus, it is impossible from the filings regarding Citigroup to determine who did what. Given that, it is impossible to know how high up the involvement went, which is a critical factor in determining the appropriate sanction as well as whether or not the Proposed Settlement is fair, reasonable, adequate or in the public interest. That is why it is essential that the SEC disclose with particularity who did what and who directly and indirectly profited from the CDO Sell & Short Scheme.

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[8] To actually learn even one name of an individual involved requires referring to the complaint filed against Mr. Stoker, which describes him as follows: "[A] Director in the CDO structuring group at Citigroup .... Stoker was the principal Citigroup employee responsible for overseeing the structuring of the [CDO Sell & Short Scheme] and the drafting of the offering memorandum and pitch book..." (SEC Stoker Compl. ¶9)

Furthermore, as is customary and typical in the financial services industry, compensation for desks and individuals is well documented not only by the individual employees and/or the specific desk seeking the money, but also in the Citigroup bonus pool allocations throughout the year and in connection with the actual payouts at year end. All that information must be disclosed if there is ever to be a proper accounting of the damage done and the ill-gotten gains received from this deal. It is also the only way anyone will really ever know who really did what (which, again, is essential to determine if the Proposed Settlement is fair reasonable, adequate or in the public interest).

The SEC's Complaint against Mr. Stoker is telling in this regard. That complaint discloses that Mr. Stoker's "immediate supervisor informed Stoker that Stoker should take action to ensure that the structuring desk received 'credit for [the CDO trading desk's] profits' on" the CDO Sell & Short Scheme. (SEC Stoker Compl. ¶33, emphasis added)

That was no idle remark. That was what it was all about: money and who got it.

That email to Mr. Stoker from his supervisor meant that he was to make sure the revenue and profits from the CDO Sell & Short Scheme were credited to that desk and the associated personnel who put the deal together and executed it thereby generated the revenue and profits.

The SEC only disclosed Mr. Stoker's compensation and even that was only disclosed in the SEC Complaint against Mr. Stoker, not in any of the filings related to the case against Citigroup:

> "Citigroup paid Stoker a salary and a bonus for his work as a structurer on CDOs, including [the CDO Sell & Short Scheme]. In 2006, Stoker was paid a salary of $150,000 and a bonus of $1,050,000. In February 2007, Stoker negotiated a salary of $150,000 and a guaranteed bonus of $2.25 million for 2007." (SEC Stoker Compl. ¶80)

Thus, literally as Mr. Stoker and his colleagues were marketing and selling the built-to-blow-up CDO Sell & Short Scheme, Citigroup agreed to increase his bonus by more than 100% to $2.25

million and to guarantee it. It is unlikely that this was a coincidence and it is even more unlikely that Mr. Stoker's supervisors, colleagues and others didn't demand the same package or more.

Additionally, those documents and payments will objectively demonstrate the roles of many, but not all, of the key personnel connected to this transaction. While there are often aggregate amounts set aside for certain desks or areas, there are also specific spreadsheets with specific names identified. A complete and total accounting of the bonus pool is essential to determine whether the Proposed Settlement should be approved. It will be a roadmap to who did what and at what level. And, it will probably show that the bonuses from this deal, which appears to have generated in excess of $600 million, exceeded $95 million.

Citigroup Caused its Investor Clients Massive and Total Losses

It appears that the investors Citigroup defrauded in the CDO Sell & Short Scheme lost their entire investments and had direct losses of at least $847 million. However, while the SEC stated that number in a related case filing, there is no detail regarding those losses and no clear statement that those were the entire direct losses.

There is also the question of indirect losses caused by Citigroup. For example, Ambac ultimately filed for bankruptcy due to its inability to pay on its obligations, including many obligations identical or similar to the CDS Citigroup purchased from it in the CDO Sell & Short Scheme. How, if at all, Citigroup contributed to the bankruptcy of Ambac is not addressed. Similarly, Ambac's obligation to pay Citigroup pursuant to the terms of the CDS was apparently effectively guaranteed by a European bank, BNP Paribas ("BNP"). There is no discussion of losses, if any, by BNP.

Indeed, there is inexplicably almost no mention of investor losses in the filings against Citigroup, other than all of the investors lost their total investments. For example, the Citigroup Complaint states that, "[a]s a result of the poor performance of the investment portfolio, the

Subordinate Investors and the Super Senior Investors lost several hundred million dollars." (Citigroup Compl. ¶ 5, emphasis added) Further, the "Subordinated Investors invested $343 million" (Citigroup Compl. ¶ 54) into the CDO Sell & Short Scheme and "lost most, if not all, of their principal when their notes became nearly worthless." (Citigroup Compl. ¶ 61)

And, "Ultimately, approximately 15 different investors purchased (or sold protection on) tranches of [the CDO Sell & Short Scheme] with a face value of approximately $843 million." (Citigroup Compl. ¶ 48, emphasis added) Ambac, apparently the largest investor, "agreed to sell protection on $500 million super senior tranches of" the CDO Sell & Short Scheme. (Citigroup Compl. ¶ 52) Ambac's performance was effectively guaranteed by BNP. (Id.)

All that is mentioned about actual losses is that "Ambac began suffering losses on the super senior tranche of [the CDO Sell & Short Scheme] towards the middle of 2008 and settled its exposure toward the end of that year after experiencing significant financial distress attributable to its losses on subprime securities, including CDOs such as [the CDO Sell & Short Scheme]. BNP has suffered additional losses on the super senior tranche of" the CDO Sell & Short Scheme. (Citigroup Compl. ¶ 62)

However, the SEC stated elsewhere that "Citigroup sold approximately $847 million of notes across the capital structure of [the CDO Sell & Short Scheme] to approximately 15 different investors." (SEC CSAC C&D ¶7, emphasis added) It also stated that "Investors in [the CDO Sell & Short Scheme] lost virtually their entire investments." (Id. ¶ 9)

Thus, it appears that investor losses were no less than $847 million, but no, one including importantly the court, should have to stitch together disclosures from multiple sources to then guess the amount of investor losses. The SEC should be required to disclose clearly and concisely all losses by all investors in connection with the CDO Sell & Short Scheme.

The Parties' Proposed Settlement Incentivizes and Rewards Fraud

The SEC trumpeted the settlement in press releases on the day it filed the court papers as a big win. One press release was entitled "Citigroup to Pay $285 Million to Settle Charges for Misleading Investors About CDO Tied to Housing Market." (TA Ex. 1) That press release also included two charts, one entitled "SEC Charges Stemming From Financial Crisis" and one entitled "SEC Monetary Recoveries." (TA Ex. 4)

The Citigroup settlement in this case was listed on the "SEC Monetary Recoveries" chart as the third highest, behind only Goldman Sachs ($550 million) and State Street ($300 million). (TA Ex. 4) Presumably the headlines generated from this press push achieved the intended affect: "Citigroup to Pay $285 Million to Settle Fraud Charges" (Wall Street Journal, TA Ex. 5) and "Citigroup has agreed to pay $285 million to investors in negligence suit, SEC says," (Washington Post, TA EX 6).

However, the total actual penalty being imposed on Citigroup for the fraudulent conduct detailed above is just $95 million, which is trivial (as demonstrated in detail in the section below). The vast majority of the $285 million "monetary recovery" is $160 million that Citigroup is "disgorging," supposedly for the ill-gotten gains it made on the fraud (plus $30 million in prejudgment interest). However, as set forth above, $160 million appears to be a fraction of the $600 million to $700 million Citigroup appears to have actually made on the CDO Sell & Short Scheme.

Disgorgement is critically important because it prevents law-breakers from profiting from their fraud. That is why disgorgement has to be full and complete. Simply put, crime should not pay. To not insist on full and compete disgorgement of all remuneration from a fraud would incentivize and reward fraud, which appears to be happening here.

While it cannot be determined with certainty, Citigroup clearly made much, much more than $160 million from the CDO Sell & Short Scheme. The SEC concedes this:

> "Citigroup realized net profits of approximately $160 million dollars in connection with" the CDO Sell & Short Scheme. (Citigroup Compl. ¶ 63, emphasis added)
>
> "Through its fees and its short positions, Citigroup realized net profits of at least $160 million in connection with" the CDO Sell & Short Scheme. (Memo p. 3, emphasis added)

While not commonly understood to be the case, the SEC uses "approximately" to be a synonym for "at least." Regardless of the appropriateness of doing that, the SEC discloses that the $160 million is a "net" number meaning that Citigroup was allowed to subtract expenses or who-knows-what from the total amount it made from the CDO Sell & Short Scheme.

That is simply grossly inadequate. Even if Citigroup had related expenses and even if some or all of those expenses were properly related, calculated and deducted, there is simply no reason not to detail them in the proposed Settlement. Without that information, there is simply no way to determine whether or not the amount of disgorgement is fair, reasonable or adequate.

And, as stated above, this is very, very important: this is the mechanism that makes fraudsters give up their ill-gotten gains and ensures that crime doesn't pay. This cannot and must not be short-circuited or crime will be incentivized and rewarded, thereby almost certainly increasingly the likelihood of more crime, particularly where there is a significant discrepancy between the $160 million disgorgement and the apparent revenue of $600-700 million.

Full and complete public disclosure is essential in connection with disgorgement. If it is not clear to the specific perpetrator and other potential perpetrators that crime does not pay, then whatever deterrent effect sought by the disgorgement will not be achieved.

A $95 Million Civil Penalty Is Trivial and Will Not Deter a Global Banking Giant like Citigroup, Much Less All of Wall Street, as the SEC Claims

$95 million is the only and total monetary penalty the SEC proposes to impose on Citigroup for its CDO Sell & Short Scheme that caused investor losses of at least $847 million. In the context of a global banking giant like Citigroup, with total assets of around $2 trillion, $95 million is less than trivial.

Moreover, without any explanation, the SEC inexplicably claims that the "proposed $95 million civil penalty will serve as an appropriate deterrent to Citigroup and other Wall Street firms from using false and misleading statements in connection with the marketing of structured products." (Memo p. 6, emphasis added) Given that $95 million is trivial to one giant financial institution like Citigroup, it will be completely meaningless to other mega-banks on Wall Street. Simply put, $95 million will have no deterrent effect on Citigroup or other Wall Street firms.

First, in connection with this particular business, Citigroup was the world's top issuer of CDOs in 2007, placing almost $50 billion in CDOs that year alone. That amount was more than 10% of the worldwide total. Citigroup issued more than $110 billion of CDOs in the three years of 2005, 2006 and 2007. (TA Ex.7 –NYT) Thus, the SEC's proposed penalty is .19% of the amount of CDOs issues by Citigroup in 2007 or .086% of the CDOs they issued over the 3 years.

When it closed on the CDO Sell & Short Scheme, Citigroup's revenue for the first quarter of 2007 was $25.5 billion with net income of $5.01 billion. (TA Ex. 8) Revenues for the second quarter of 2007 were $26.6 billion with net income of $6.2 billion. (TA Ex. 9) Revenues for the third quarter were $22.4 billion with net income of $2.2 billion. (TA Ex. 10) Revenues for all of 2007 were $81.7 billion and net income was $3.62 billion (due to substantial write downs arising from toxic assets in the second half of the year). (TA Ex. 11) As of December 31, 2007, Citigroup had just under $2.2 trillion in total assets. (TA Ex. 12)

Citigroup's current revenues and earnings tell the same story: in the last three months (i.e., the third quarter of 2011), Citigroup had revenues of $20.8 billion with net income of $3.8 billion. (TA Ex. 13) Second quarter 2011 revenues were $20.6 billion with $3.3 billion in net income. (TA Ex. 14) For all of 2010, Citigroup revenues were $86.6 billion with net income of $10.6 billion. (TA Ex. 15) Total assets at September 30, 2011 were $1.94 trillion. (TA Ex. 16)

Looking at Citigroup compensation also shows that $95 million is trivial. In 2007 alone, the top 8 officers of Citigroup were paid $70,549,469 in compensation – for that one year. (TA Ex. 17) Moreover, for the five years from 2004 – 2008, Citigroup paid its CEO, just one individual, slightly less than $90 million. (TA Ex. 18)

Looked at from the perspective of Wall Street, wages in 2007 were $73 billion. Bonuses in 2007 alone were $33.2 billion, following bonuses of $34. 3 billion in 2006 and $25.6 billion in 2005. (TA Ex. 19) The largest financial firms headquartered in New York "were on track to set a new record during the first half of 2007," but the growing write offs from "toxic assets" prevented that record from being set. However, those firms still reported a net profit of $11.8 billion for 2007. (TA. Ex. 20)

The $95 million can be looked at other ways. For example, in 2007, it was reported that Citigroup spent more than $600 million on advertising. (TA Ex. 21) In that year, Citigroup made charitable contributions of $145 million. (TA Ex. 22) In May of 2007, Citigroup announced it was directing "$50 billion over the next 10 years to address global climate change." (TA Ex. 23)

Moreover, the $95 million penalty is almost the exact amount of worthless securities Citigroup removed from its proprietary books and sold at inflated prices ($92.25 million) to the soon-to-be-worthless deal it was marketing to unsuspecting investors. Thus, the "penalty" is merely equal to Citigroup's gain from just one sliver of the fraudulent scheme it perpetrated.

There is no indication that the SEC took this secret sale and other significant fraudulent conduct by Citigroup into account when it decided on this paltry penalty.

Also, at the same time this fraudulent built-to-blow-up deal was being marketed and sold to investors, Citigroup agreed to increase the bonus for just one of its involved employees (Mr. Stoker) by more than 100% to $2.25 million and to guarantee it. Because the SEC provided virtually no information on any individuals involved in this fraud, it is impossible to know the total bonus payout from this scheme was, but it would be reasonable to believe that the total bonuses paid exceeded $95 million.

The Proposed Settlement Does Not Serve the Public Interest

The Proposed Settlement is not in the public interest.[9] It is as inexplicable as it is inexcusable for the SEC to provide such minimal information regarding this case. Such conduct only raises suspicions, which the SEC can ill afford, that this is an overly favorable deal for a rich, powerful and connected mega-bank and that the SEC is again letting the American people down by failing to properly police Wall Street.

In light of the financial catastrophe that has happened to the country, the central role of Wall Street and the global banking giants, the utter failure of regulators to protect the American people, the massive taxpayer bailouts required and the ongoing suffering from the worst

[9] The SEC has contradicted itself on the public interest test in this case. The very first and last argument the SEC made to the court on Oct.19, when it filed the proposed settlement was: "The standard for judicial review and approval of proposed consent judgments in [SEC] enforcement actions is whether they serve the public interest" and "[T]he [SEC] submits that the proposed consent judgment is fair, adequate, reasonable and in the public interest." (Oct. Memo pp. 4, 7 emphasis added, citations omitted). Contradicting itself, the SEC then repeatedly argued in its response to the Court's Oct. 27 Order that serving the public interest was not part of the settlement approval test. (Nov. Memo pp. 4-5) Shockingly, the SEC then flipped again, arguing Better Markets should not be allowed to intervene because it, the SEC, adequately protected the public interest. (Nov. Opp. Memo p. 5, 8) The SEC was right the first time: the test includes whether or not the settlement serves the public interest. (See SEC's Oct. Memo pp. 2-7 and cases cited)

economy since the Great Depression, the SEC should be going out of its way to ensure that the American public has trust and faith that it is going after corporations that commit fraud without fear or favor. Regrettably, the Proposed Settlement does just the opposite.

It is simply not in the public interest to sweep yet more egregious fraudulent conduct from the 2008 Wall Street meltdown under the rug with such information made public. These settlements with gigantic, rich, powerful and connected Wall Street banks that played such a central role in the near-collapse of the global financial system appear indefensible.

The public interest is only served by transparent and accountable government and that includes the regulatory agencies, particularly in light of their many failures before, during and after the financial crisis.

If the SEC refuses to obtain and publicly disclose all the facts and circumstances about the CDO Sell & Short Scheme, then the Court must order it to do so. Nothing less will be in the public interest. In addition, if, as Citigroup's spokesperson claims, this case concludes the SEC's investigation and prosecution of all of Citigroup's more than $125 billion in CDO deals, the SEC must be required to disclose the full basis for that as well.

The Proposed Settlement Should Be Rejected Because Citigroup Claims it Settles More Than $145 billion in CDO Deals

At best, there is a dispute about the scope of immunity Citigroup is obtaining from the Proposed Settlement. The Consent states "Consistent with 17 C.F.R. sec. 202.5(f), this Consent resolves only the claims asserted against Defendant in this civil proceeding." (Consent ¶ 13, emphasis added)

However, a Citigroup spokesperson was quoted stating that this settlement "means that the SEC has completed its CDO investigation(s) of Citi." (Ex. 24) This statement was made in writing to a reporter via an email. Given it was well known that this settlement was going to

generate significant and broad media coverage, this statement was undoubtedly well thought out, carefully written, cautiously reviewed by the top lawyers and most assuredly approved at the highest levels of Citigroup.

An SEC spokesperson's response appears to have been carefully crafted as well and was decidedly not a denial of what the Citigroup's spokesperson said. For example, the SEC did not say that investigations of other Citigroup CDO deals are ongoing. Rather, it said they'd bring "further charges where we determined that there has been unlawful conduct." Of course, Citigroup does not have to worry about that if, as its spokesperson stated, the investigations are over. Tellingly, no one from Citigroup has retracted or modified the spokesperson's statement.

The full quote is as follows:

> "It [the settlement] made no mention of the dozens of similar collateralized debt obligations, or CDOs, Citi sold to investors before the crash. "
>
> "A bank spokesman said the SEC could not be examining any of those deals. 'This means that the SEC has completed its CDO investigation(s) of Citi,' the spokesperson asserted in an email."
>
> ""The $285 million settlement resolves only the Class V Funding III CDO, and we will not hesitate to bring further charges where we determine that there has been unlawful conduct,' an SEC spokesman said." (TA Ex. 24)

The Court should convene an evidentiary hearing and call the Citigroup individuals who made, knew about or discussed those statements and all information related to Citigroup's claim that this single settlement is in fact settling Citigroup's liability for more than $145 billion in Citigroup's other CDO deals, all for just $285 million, about one-twentieth of one percent.

The Other Provisions of the Proposed Settlement Are Also Deficient

Citigroup is also consenting to (1) an injunction ordering it not to violate section 17(a)(2) of the Securities Act and (2) to comply with certain undertakings for a period of 3 years

regarding the review and approval process for offerings of CDOs and other residential mortgage-related securities.

The SEC states that the "undertakings are narrowly tailored to the violations and represent appropriate remedial relief." (Memo p. 7) Given that the securitization and derivative markets for residential mortgage-related securities are effectively shut down, the undertaking with respect to offerings of CDOs and other "residential mortgage-related securities" is hollow.

Moreover, this misconceives the fraudulent scheme and the conduct of Citigroup. The referenced securities used in this particular fraud (residential mortgage-backed securities) are not the material aspect around which such an undertaking should be fashioned. Citigroup merely used such referenced securities because that happened to be what was available and usable at the time. Moreover, it also related to the proprietary exposure it had on its books at that time.

Thus, any undertaking tailored to the fraudulent conduct here must target the process for creating, structuring, marketing, offering, selling, shorting and profiting from (1) proprietary trades of any type with particular focus on any such deal involving derivatives, and (2) all structured, securitized or collateralized products regardless of whether or not they relate to residential mortgage-related securities. After all, a "CDO" is just a collateralized debt obligation. Any debt will do depending on market conditions at the time. The reference securities just happened to be residential mortgage-related securities for the CDO Sell & Short Scheme, but the actual type of reference securities are immaterial to the fraudulent conduct and business model used to perpetrate the fraud.

Only that undertaking will meaningfully address the core of the fraud and fraudulent activities Citigroup engaged in. Similarly, an injunction focused solely on Section 17 and not any of the anti-fraud provisions is woefully inadequate and inappropriate.

Moreover, under the Proposed Settlement, Citigroup does not admit or deny any of the allegations in the Citigroup Complaint and agrees not to deny them. However, there is a huge exception to this: Citigroup is allowed to expressly and directly deny all of the allegations in any litigation or other legal proceedings in which the SEC is not a party. (Consent ¶¶ 2, 14)

Thus, even the provision of the Proposed Settlement not to admit or deny is very limited and may well result in Citigroup denying all the allegations, albeit in other legal proceedings not involving the SEC.

CONCLUSION

For the reasons set forth above, the Proposed Settlement should be rejected because it is not fair, reasonable, adequate or in the public interest (*SEC v. Bank of America,* 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009) and the Court should issue an order requiring the Parties to provide the Court with the necessary information.

EXHIBIT A

TO *AMICUS CURIAE* BRIEF IN OPPOSITION TO PROPOSED SETTLEMENT

EXHIBIT A

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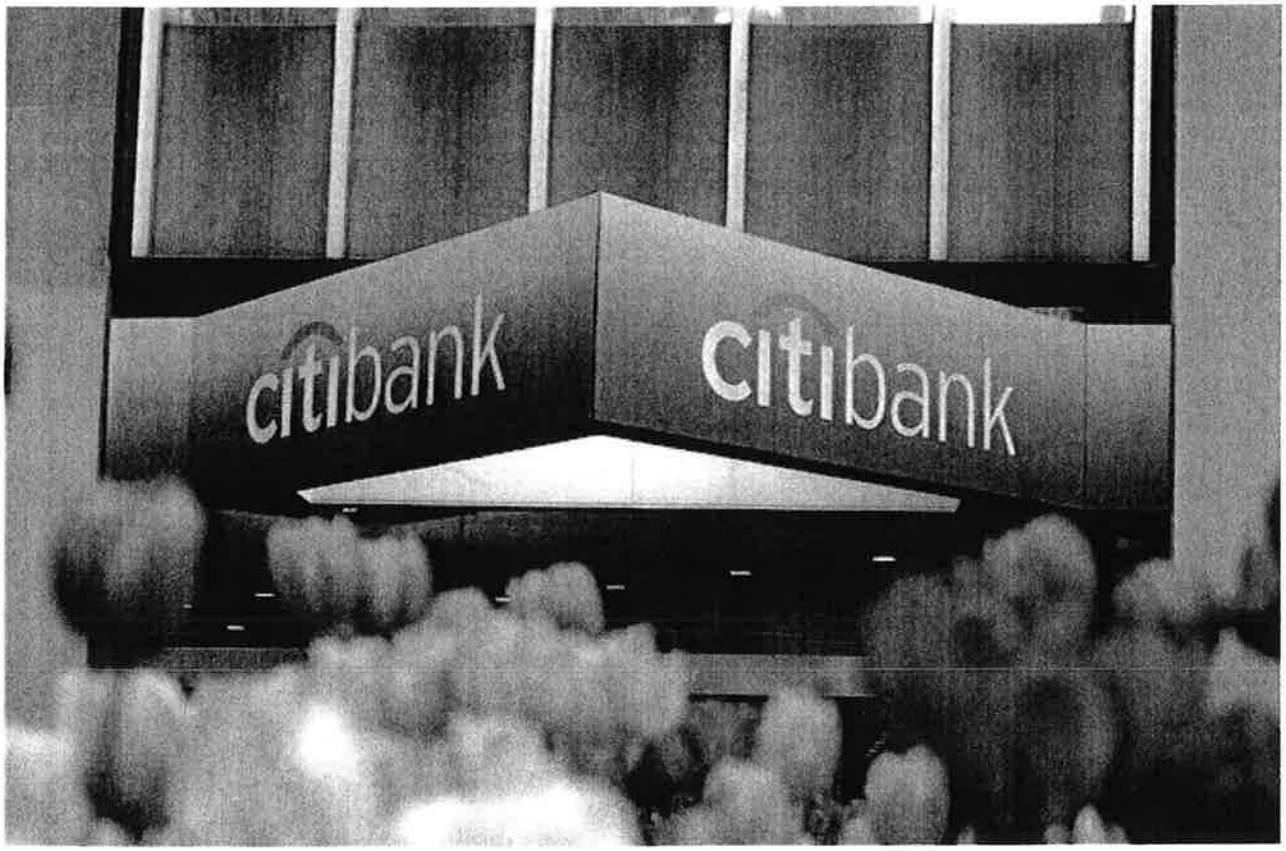
The Wall Street Money Machine

Did Citi Get a Sweet Deal? Bank Claims SEC Settlement on One CDO Clears It on All Others



(Flickr: digiart2001)

by Jesse Eisinger and Jake Bernstein
ProPublica, Oct. 20, 2011, 3:21 p.m.

In the run-up to the global financial collapse, Citigroup's bankers worked feverishly to create complex securities. In just one year, 2007, Citi marketed more than $20 billion worth of deals backed by home mortgages to investors around the world, most of which failed spectacularly. Subsequent lawsuits and investigations turned up evidence that the bank knew that some of the products were low quality and, in some instances, had even bet they would fail.

The bank says it has settled all of its potential liability to a key regulator – the Securities and Exchange Commission -- with a $285 million payment that covers a single transaction, Class V Funding III. ProPublica first raised questions about the deal [1] in August 2010. In announcing a case, the SEC said it had identified one low-level employee, Brian Stoker, as responsible for the bank's misconduct.

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It made no mention of the dozens of similar collateralized debt obligations, or CDOs, Citi sold to investors before the crash.

A bank spokesman said the SEC would not be examining any of those deals. "This means that the SEC has completed its CDO investigation(s) of Citi," the spokesman asserted in an e mail.

"The $285 million settlement resolves only the Class V Funding III CDO, and we will not hesitate to bring further charges where we determine that there has been unlawful conduct," an SEC spokesman said.

Did Citi get a sweet deal? Some observers think so.

"Citibank arranged countless CDOs that were built to fail, but the SEC apparently limited its case to a single CDO where they had particularly vivid and powerful proof," says Stephen Ascher, a securities litigator at Jenner & Block, which has sued Citibank on various structured finance transactions.

"This represents extreme caution, at best -- and a failure to grapple with the magnitude and harmfulness of the misconduct, at worst."

ProPublica has been investigating the practices of the investment banks in the lead-up to the financial crisis for three years. Our research found a number of Citi CDOs similar to the deal featured in the SEC's Class V complaint, and more information on Citi's CDO business has emerged in lawsuits and subsequent investigations. Responsibility for these practices did not begin or end with Mr. Stoker. Among the questions still unanswered: How much did Stoker's immediate bosses know? What did the heads of Citigroup's CDO business, fixed income business and trading businesses know about Citi's CDO dealings?

In the settlement announced this week, the SEC charged Citigroup with misleading its clients in the $1 billion Class V Funding III. The regulator said that the bank failed to disclose that it, rather than a supposedly independent collateral manager, had played a key role in choosing the assets in the deal when the bank marketed it to clients. Citigroup also failed to tell its clients that it retained a short position, or bet against, the CDO it created and sold. In addition to the $285 million fine, the SEC also charged Credit Suisse Alternative Capital, which was supposed to choose the assets that went into the CDO, and a low-level executive at that firm, with securities law violations.

Stoker becomes only the second investment banker after Goldman Sachs' Fabrice "Fabulous Fab" Tourre to be charged by the SEC in conjunction with the business of creating CDOs, which were at the heart of the financial collapse in the fall of 2008. According to the SEC, Stoker played a leading role in structuring Class V Funding III. Stoker declined to comment. His lawyer has said he is fighting the charges.

The SEC complaint shows that Stoker was regularly communicating with other Citi executives about his actions. One top Citi executive coaches employees in an email that Credit Suisse should tell potential buyers of Class V about how it decided to purchase the assets, even though Citi, not Credit Suisse, was making the calls.

In October 2006, people from Citi's trading desk approached Stoker about shorting deals that Citi arranged. Later, in Nov 3, 2006, Stoker's immediate boss inquired about Class V Funding III. Stoker told his boss that he hoped the deal would go through. He wrote that the Citi trading group had taken a position in the deal. Citi's trading desk was shorting Class V Funding III, betting that its value would fall. Stoker noted that Citi shouldn't tell Credit Suisse officials what was going on, and that Credit Suisse had agreed to be the manager of the CDO "even though they don't get to pick the assets." Less than two weeks later, this executive pressed Stoker to make sure that their group at Citi got "credit" for the profits on the short.

This Citi official, unnamed in the complaint, was not charged by the SEC.

If Class V Funding III was some outlier, the SEC's action might make more sense. But it wasn't. Citigroup's CDO operation churned out at least 18 CDOs around the same period. Often they were large CDOs, created with credit default swaps, effectively a bet that a given bond will rise or fall. Most of the CDOs included recycled Citi assets that the bank couldn't sell. By purchasing pieces of its older deals, Citigroup could complete deals and keep the prices for CDO assets higher than they otherwise would be. Some investors helped picked the assets and then bet against them, facts that Citi didn't clearly disclose to other investors in the deals.

Closing the book on Citi's CDO business means the public may never know the true story of Citigroup's, and Wall Street's, actions during the financial crisis. One of the largest victims of the CDOs was the bond insurer Ambac. The now-bankrupt firm settled with Citi in 2010, long before it got to the root of the problems with securities Citi convinced it to insure. A shareholder class action lawsuit that is wending its way through the courts has the potential to reveal some details, but often such cases are settled with evidence then sealed from public view.

Among the unresolved questions: What was Citigroup's role in a series of deals involving Magnetar, an Illinois-based hedge fund that invested in small portions of CDOs and then made big bets against them? Our investigation showed that Citi put together at least 5 Magnetar CDOs worth $6.5 billion [2]. Did Citi mislead the investors who lost big on these deals?

Here are some other questions about Citi CDOs created around the time of Class V Funding III:

888 Tactical Fund. A February 2007, $1 billion deal, it had a significant portion of other Citi deals in it. Did the bank have influence over the selection of the assets, as it did in Class V Funding III?
Adams Square Funding II. A $1 billion March 2007 deal. The pitch-book to clients for Class V Funding III was adapted almost wholesale from this deal, according to the SEC complaint. Was Citigroup shorting this deal, or adding assets that were selected by others to short the deal? And was that adequately disclosed to clients?
Ridgeway Court Funding II. Completed in June 2007, this $3 billion deal contained a mysterious $750 million position in a CDO index. Experts believe that such positions were included for the purposes of shorting the market. Did Citi disclose why it included these assets to the investors in this CDO? As much as 30 percent of the assets in the deal were from unsold Citi CDOs. Was this a dumping ground for decaying assets the bank could not unload, as a lawsuit by Ambac, which was settled, charged?
Armitage. This $3 billion March 2007 CDO looked a lot like Ridgeway II. It had a large portion of other CDOs, much of which came from other Citi deals, including $260 million from Adams Square Funding II. Did Citi adequately disclose to investors what they were buying?
Class V Funding IV. A $2 billion June 2007 deal, Citi appears to have done this directly with Ambac. The SEC complaint about Class V Funding III makes it clear that Ambac was unaware of Citi's position in that deal. Did the bank disclose more to Ambac in this deal?
Octonion. This $1 billion March 2007 CDO bought some of Adams Square Funding II. Adams Square II bought a piece of Octonion. A third CDO, Class V Funding III, also bought some of Octonion. Octonion, in turn, bought a piece of Class V Funding III. How did Citi and the collateral managers involved in these deals justify this daisy chain of buying?

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1. http://www.propublica.org/article/banks-self-dealing-super-charged-financial-crisis/single
2. http://www.propublica.org/special/the-timeline-of-magnetars-deals

EXHIBIT B

TO *AMICUS CURIAE* BRIEF IN OPPOSITION TO PROPOSED SETTLEMENT

EXHIBIT B

Bloomberg

Citigroup Finds Obeying the Law Too Darn Hard: Jonathan Weil

By Jonathan Weil - Nov 2, 2011

Five times since 2003 the Securities and Exchange Commission has accused Citigroup Inc. (C)'s main broker-dealer subsidiary of securities fraud. On each occasion the company's SEC settlements have followed a familiar pattern.

Citigroup neither admitted nor denied the SEC's claims. And the company consented to the entry of either a court injunction or an SEC order barring it from committing the same types of violations again. Those "obey-the-law" directives haven't meant much. The SEC keeps accusing Citigroup of breaking the same laws over and over, without ever attempting to enforce the prior orders. The SEC's most recent complaint against Citigroup, filed last month, is no different.

Enough is enough. Hopefully Jed Rakoff will soon agree.

Rakoff, the U.S. district judge in New York who was assigned the newest Citigroup case, is saber-rattling again, threatening to derail the SEC's latest wrist-slap. The big question is whether he has the guts to go through with it. Twice since 2009, Rakoff has put the SEC through the wringer over cozy corporate settlements, only to give in to the agency later.

That the SEC went easy on Citigroup again is obvious. The commission last month accused Citigroup of marketing a $1 billion collateralized debt obligation to investors in 2007 without disclosing that its own traders picked many of the assets for the deal and bet against them. The SEC's complaint said Citigroup realized "at least $160 million" in profits on the CDO, which was linked to subprime mortgages. For this, Citigroup agreed to pay $285 million, including a $95 million fine -- a pittance compared with its $3.8 billion of earnings last quarter.

Looking Deliberate

On top of that, the agency accused Citigroup of acting only negligently, though the facts in the SEC's complaint suggested deliberate misconduct. The SEC named just one individual as a defendant, a low-level banker who clearly didn't act alone. Plus, the SEC's case covered only one CDO, even though Citigroup sold many others like it.

Here's what makes the SEC's conduct doubly outrageous: The commission already had two cease-and-desist orders in place against the same Citigroup unit, barring future violations of the same section of the securities laws that the company now stands accused of breaking again. One of those orders came in a 2005 settlement, the other in a 2006 case. The SEC's complaint last month didn't mention either order, as if the entire agency suffered from amnesia.

The SEC's latest allegations also could have triggered a violation of a court injunction that Citigroup agreed to in 2003, as part of a $400 million settlement over allegedly fraudulent analyst-research reports. Injunctions are more serious than SEC orders, because violations can lead to contempt-of-court charges.

The SEC neatly avoided that outcome simply by accusing Citigroup of violating a different fraud statute. Not that the SEC ever took the prior injunction seriously. In December 2008, the SEC for the second time accused Citigroup of breaking the same section of the law covered by the 2003 injunction, over its sales of so-called auction-rate securities. Instead of trying to enforce the existing court order, the SEC got yet another one barring the same kinds of fraud violations in the future.

It gets worse: Each time the SEC settled those earlier fraud cases, Citigroup asked the agency for waivers that would let it go about its business as usual. (This is standard procedure for big securities firms.) The SEC granted those requests, saying it did so based on the assumption that Citigroup would comply with the law as ordered. Then, when the SEC kept accusing Citigroup of breaking the same laws again, the agency granted more waivers, never revoking any of the old ones.

Legal Standard

Rakoff seems aware of the problem, judging by the questions he sent the SEC and Citigroup last week. Noting that the SEC is seeking a new injunction against future violations by Citigroup, he asked: "What does the SEC do to maintain compliance?" Additionally, he asked: "How many contempt proceedings against large financial entities has the SEC brought in the past decade as a result of violations of prior consent judgments?" We'll see if the SEC finds any. A hearing is set for Nov. 9.

The legal standard Rakoff must apply is whether the proposed judgment is "fair, reasonable, adequate and in the public interest." Among Rakoff's other questions: "Why should the court impose a judgment in a case in which the SEC alleges a serious securities fraud but the defendant neither admits nor denies wrongdoing?" And this: "How can a securities fraud of this nature and magnitude be the result simply of negligence?"

A Citigroup spokeswoman, Shannon Bell, said, "Citi has entered into various settlements with the SEC over the years, and there is no basis for any assertion that Citi has violated the terms of any of those settlements." I guess it depends on the meaning of the words "settlement" and "violated."

Rakoff gained fame in 2009 when he rejected an SEC proposal to fine Bank of America Corp. (BAC) $33 million for disclosure violations related to its $29.1 billion purchase of Merrill Lynch & Co. Rakoff said the settlement punished Bank of America shareholders for the actions of its executives, none of whom were named as defendants.

Months later, though, Rakoff approved a $150 million fine for the same infractions, on the condition that the money would be redistributed to Bank of America stockholders who supposedly were harmed. The stipulation was classic window dressing. Even so, Rakoff became something of a folk hero, simply for daring to question an SEC settlement. Most other judges are rubber stamps.

Rakoff would serve the public well by rejecting any deal that leaves the truth of the SEC's allegations undetermined or fails to treat Citigroup as a repeated offender. Grandstanding alone won't cut it anymore. Rakoff has come a long way already. Here's hoping this time he goes the distance.

(Jonathan Weil is a Bloomberg View columnist. The opinions expressed are his own.)

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November 7, 2011

Promises Made, and Remade, by Firms in S.E.C. Fraud Cases

By EDWARD WYATT

WASHINGTON — When Citigroup agreed last month to pay $285 million to settle civil charges that it had defrauded customers during the housing bubble, the Securities and Exchange Commission wrested a typical pledge from the company: Citigroup would never violate one of the main antifraud provisions of the nation's securities laws.

To an outsider, the vow may seem unusual. Citigroup, after all, was merely promising not to do something that the law already forbids. But that is the way the commission usually does business. It also was not the first time the firm was making that promise.

Citigroup's main brokerage subsidiary, its predecessors or its parent company agreed not to violate the very same antifraud statute in July 2010. And in May 2006. Also as far as back as March 2005 and April 2000.

Citigroup has a lot of company in this regard on Wall Street. According to a New York Times analysis, nearly all of the biggest financial companies — Goldman Sachs, Morgan Stanley, JP Morgan Chase and Bank of America among them — have settled fraud cases by promising that they would never again violate an antifraud law, only to have the S.E.C. conclude they did it again a few years later.

A Times analysis of enforcement actions during the past 15 years found at least 51 cases in which the S.E.C. concluded that Wall Street firms had broken anti-fraud laws they had agreed never to breach. The 51 cases spanned 19 different firms.

On Wednesday, Judge Jed S. Rakoff of the Federal District Court in Manhattan, an S.E.C. critic, is scheduled to review the Citigroup settlement. Judge Rakoff has asked the agency what it does to ensure companies do not repeat the same offense, and whether it has ever brought contempt charges for chronic violators. The S.E.C. said in a court filing Monday that it had not brought any contempt charges against large financial firms in the last 10 years.

Since the financial crisis, the S.E.C. has been criticized for missing warning signs that could have softened the blow. The pattern of repeated accusations of securities law violations adds another layer of concerns about enforcing the law. Not only does the S.E.C. fail to catch many instances of wrongdoing, which may be unavoidable, given its resources, but when it is on the case, financial firms often pay a relatively small price.

Senator Carl Levin, a Michigan Democrat who is chairman of the Senate permanent subcommittee on investigations and has led several inquiries into Wall Street, said the S.E.C.'s method of settling fraud cases, is "a symbol of weak enforcement. It doesn't do much in the way of deterrence, and it doesn't do much in the way of punishment, I don't think."

Barbara Roper, director of investor protection for the Consumer Federation of America, said, "You can look at the record and see that it clearly suggests this is not deterring repeat offenses. You have to at least raise the question if other alternatives might be more effective."

S.E.C. officials say they allow these kinds of settlements because it is far less costly than taking deep-pocketed Wall Street firms to court and risking losing the case. By law, the commission can bring only civil cases. It has to turn to the Justice Department for criminal prosecutions.

Robert Khuzami, the S.E.C.'s enforcement director, said never-do-it again promises were a deterrent especially when there were repeated problems. In their private discussions, commissioners weigh a firm's history with the S.E.C. before they settle on the amount of fines and penalties. "It's a thumb on the scale," Mr. Khuzami said. "No one here is disregarding the fact that there were prior violations or prior misconduct," he said.

But prior violations are plentiful. For example, Bank of America's securities unit has agreed four times since 2005 not to violate a major antifraud statute, and another four times not to violate a separate law. Merrill Lynch, which Bank of America acquired in 2008, has separately agreed not to violate the same two statutes seven times since 1999.

Of the 19 companies that the Times found by the S.E.C. to be repeat offenders over the last 15 years, 16 declined to comment. They read like a Wall Street who's who: American International Group, Ameriprise, Bank of America, Bear Stearns, Columbia Management, Deutsche Asset Management, Credit Suisse, Goldman Sachs, JPMorgan Chase, Merrill Lynch, Morgan Stanley, Putnam Investments, Raymond James, RBC Dain Rauscher, UBS and Wells Fargo/Wachovia.

Two others, Franklin Advisers and Massachusetts Financial, said that their two settlements were made simultaneously and therefore one incident did not violate a previous cease-and-desist order.

A spokesman for Citigroup said "there is no basis for any assertion that Citi has violated the terms" of any settlement.

But some experts view many settlements as essentially meaningless, particularly since they usually do not require a company to admit to the accusations leveled by the S.E.C. Nearly every settlement allows a company to "neither admit nor deny" the accusations — even when the company has admitted to the same charges in a related case brought by the Justice Department — so that they are less vulnerable to investor lawsuits.

In 2005, Bank of America was one of several companies singled out for allowing professional traders to buy or sell a mutual fund at the previous day's closing price, when it was clear the next day that the overall market or particular stocks were going to move either up or down sharply, guaranteeing a big short-term gain or avoiding a significant loss.

In its settlement, Bank of America neither admitted nor denied the conduct, but agreed to pay a $125 million fine and to put $250 million into a fund to repay investors. The company also agreed never to violate the major antifraud statutes.

Two years later, in 2007, Bank of America was accused by the S.E.C. of fraud by using its supposedly independent research analysts to bolster its investment banking activities from 1999 to 2001. In the settlement, Bank of America without admitting or denying its guilt, paid a $16 million fine and promised, once again, not to violate the law.

But two years later, in 2009, the S.E.C. again accused Bank of America of defrauding investors, saying that in 2007-8, the bank sold $4.5 billion of highly risky auction-rate securities by promising buyers that they were as safe as money market funds. They weren't, and this time Bank of America agreed to be "permanently enjoined" from violating the same section of the law it had previously agreed not to break.

In fact, the company had already violated that promise, according to the S.E.C when it was accused last year of rigging bids in the municipal securities market from 1998 through 2002. To settle the charges, Bank of America paid no penalty, but refunded investors $25 million in profits plus $11 million in interest. And, the bank promised again never to violate the same law.

The S.E.C. led the bank settle without admitting or denying the charges, even though Bank of America had simultaneously settled a case with the Justice Department's antitrust division admitting the same conduct.

Companies routinely argue that while they may be settling multiple violations of the same law, the facts of each case are different — and therefore not exactly a repeat offense.

But Jayne Barnard, a law professor at the William & Mary Law School who has studied repeat securities fraud violators, said "it stretches the truth" to claim that a company's multiple violations of the same law "are just a freakish coincidence."

The S.E.C. can target repeat violations. It could bring civil contempt charges against a company for violating one of orders, but it rarely does. The S.E.C. does not publicly refer to previous cases when filing new charges.

Mr. Khuzami, the agency enforcement chief, said it prefers to use its resources to bring charges of new violations against a company rather than to pursue contempt charges in court.

"If you've got a company that settles a case involving its research analysts one year, and several years later it is accused of fraud in selling a C.D.O. to customers, those are very different parts of a company," Mr. Khuzami said, referring to collateralized debt obligations, a form of derivative that contributed to the housing bubble.

Donna M. Nagy, a professor at the Indiana University law school and an author of a widely used textbook on securities law enforcement, said that by ignoring previous accusations of violations, the S.E.C. was minimizing the value of its actions.

Edward Skyler, a spokesman for Citigroup, said that the fact that the company entered into a $285 million settlement last month does not mean that it had violated the terms of any previous settlement. "Like all other major financial institutions, Citi has entered into various settlements with the S.E.C. over the years and there is no basis for any assertion that Citi has violated the terms of any of those settlements," he said.

Mr. Levin, the Michigan senator, said he believed that the S.E.C.'s settlements were the problem. "It's like a cop giving out warnings instead of giving tickets," he said. "It's a green light to operate the same way without a lot of fear that the boom is going to be lowered on you."

EXHIBIT C

TO *AMICUS CURIAE* BRIEF IN OPPOSITION TO PROPOSED SETTLEMENT

EXHIBIT C

Exhibit C

Citigroup's fraudulent conduct in rough chronological order in planning, structuring, marketing, selling and shorting the CDO Sell & Short Scheme, included:[1]

1. Conceived of as a proprietary trade from the start;
2. Modeled potential shorts to determine exactly which securities were virtually guaranteed to fail and provide Citigroup with the biggest payoff in the shortest amount of time, which would also cause the biggest losses to the investors they sold the deal to, i.e., their customers;
3. Selected a list of derivatives that it owned from its proprietary inventory of "unsold" derivatives and certain reference securities based on its modeling and other inside knowledge;
4. Selected only those derivatives that Citigroup believed were worthless or virtually certain to be worthless in a very short period of time, evidenced by, among other things, widening spreads for the derivatives;
5. The selection of derivatives that Citigroup believed were worthless or virtually certain to be worthless in a very short period of time was also evidenced by the comments of sophisticated market participants at the time Citigroup was marketing the CDO Sell & Short Scheme to investors, including:
    a. The portfolio is "a collection of dogsh!t"
    b. "Possibly the best short EVER!" and
    c. "The portfolio is horrible"
6. Identified an experienced, highly regarded, independent, brand-name third party investor representative[2] ("Investor Representative") who might enable their fraud by falsely claiming:
    a. to represent the interests of prospective investors;
    b. to be independent from Citigroup; and
    c. to rigorously analyze, scrutinize and select the proposed investments, among other things;
7. Sent a list of virtually worthless or soon-to-be-worthless proprietary derivatives and/or reference securities "contemplated to be in the" deal to the prospective Investor Representative;
8. Determined that the prospective Investor Representative would be "amenable" and "receptive" to participate in the deal and to include Citigroup's selection of at least some of the collateral;
9. Sent a draft engagement letter to the prospective Investor Representative only after confirming it was "amenable" and "receptive," which meant, among other things, it was

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[1] This conduct is set forth in, referred to in or extrapolated from the Citigroup Complaint, the *SEC v Stoker* Complaint (TA Ex. 2), and the SEC Administrative Proceeding against CSAC (TA Ex 3).

[2] This was Credit Suisse Alternative Capital LLC. See SEC Stoker Compl. ¶ 11, TA Ex. 2; SEC CSAC C&D, Ex. 3.

willing to lie to prospective investors about the key terms of the deal, i.e., "agreed to terms even though they don't get to pick the assets";

10. Picked the derivatives it wanted to short in the deal and ensured the prospective Investor Representative included those specific derivatives in the deal;
11. Executed an engagement letter with the prospective Investor Representative which had the stated responsibility to identify, analyze, select and "direct the purchase of securities" for the investment portfolio to subsequently be sold to investors;
12. Doubled the size of the transaction to almost $1 billion;
13. Leveraged "exposure to the housing market and therefore magnified the severity of the losses suffered by investors"
14. Doubled the credit exposure to the Citigroup selected derivatives;
15. Doubled Citigroup's short position on those selected derivatives to almost $500 million, $490 million of which were naked shorts, i.e., Citigroup was not hedging any exposure it had by the short - it was a pure bet by Citigroup that the derivatives were going to fail;
16. Informed "Citigroup's Risk Management organization" that it was going to profit from the failure of the deal "even as it was marketing [it] to investors";
17. Produced the fraudulent marketing materials (i.e., offering circular and a pitch book)[3] to induce investors to invest and to induce a credit protection seller to sell it a $500 million CDS;
18. Used the fraudulent marketing materials to solicit prospective investors;
19. Included specific fraudulent representations in the marketing materials that the Investor Representative
    a. was the collateral manager;
    b. had selected the collateral, i.e., the derivatives and reference derivatives in the deal; and
    c. applied a "rigorous approach to the selection of assets for the investment portfolio of CDOs" that it was going to manage;
20. Emphasized the fraudulently claimed independence and derivatives selection capability of the Investor Representative by, among other things, stating "six" separate times "that the investment portfolio was 'selected' by" the Investor Representative, among other lies that would be essential to induce investors to invest (Citigroup Compl. ¶ 42, emphasis added);
21. Ensured that there was no disclosure of Citigroup's role in
    a. picking approximately 50% of the derivatives and the reference securities;
    b. picking the Investor Representative only after confirming that it would participate in and enable Citigroup's fraudulent scheme; and
    c. shorting $500 million of the $1 billion deal;
22. Ensured that the marketing materials had all the representations (and omissions) necessary to fraudulently assure prospective investors that an experienced, highly regarded, independent, brand-name third party Investor Representative was calling the shots, protecting the investors, and ensuring that Citigroup didn't have any role that could or would compromise the integrity of the deal;

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[3] Indicative of the assembly line nature of Citigroup's CDO deals, the pitch book used here was created by marking up a pitch book for another deal "Citigroup and CSAC had collaborated in early January 2007." (SEC Stoker Compl. ¶ 47-50)

23. Provided fraudulent information directly or indirectly through the Investor Representative to specific prospective investors who asked specific questions;
24. Sold their proprietary positions at significantly inflated, non-market prices knowing that the marketing materials-stated assets would only be purchased at fair market value;
25. Marketed, offered and sold the deal to "many of Citigroup's institutional clients, including a variety of hedge funds; asset managers, including CDO managers; and both U.S. and foreign financial institutions";
26. Provided the marketing materials to a prospective seller of credit insurance as well as to the bank guaranteeing the performance of that CDS seller;
27. Knew that an experienced, highly regarded, independent third party Investor Representative was critically important to the prospective seller and guarantor of credit insurance;
28. Ensured that the due diligence process of the prospective seller and guarantor of the credit insurance did not uncover the fraudulent scheme or learn that there was in fact no independent third party Investor Representative; and
29. Bought through "an affiliate of Citigroup" the CDS from the Investor Representative at below market rates, thereby shorted $500 million of the $1 billion dollar deal. (SEC Memo p. 2)

This fraudulent scheme closed on February 28, 2007 (when Citigroup was paid $34 million in fees) and, effective March 16, 2007, Citigroup shorted $500 million of it by purchasing CDS. (Citigroup Compl. ¶ 52)