Citigroup Affiliates to Pay $180 Million to Settle Hedge Fund Fraud Charges

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Washington D.C., Aug. 17, 2015 — The Securities and Exchange Commission today announced that two Citigroup affiliates have agreed to pay nearly $180 million to settle charges that they defrauded investors in two hedge funds by claiming they were safe, low-risk, and suitable for traditional bond investors. The funds later crumbled and eventually collapsed during the financial crisis.

Citigroup Global Markets Inc. (CGMI) and Citigroup Alternative Investments LLC (CAI) agreed to bear all costs of distributing the $180 million in settlement funds to harmed investors.

An SEC investigation found that the Citigroup affiliates made false and misleading representations to investors in the ASTA/MAT fund and the Falcon fund, which collectively raised nearly $3 billion in capital from approximately 4,000 investors before collapsing. In talking with investors, they did not disclose the very real risks of the funds. Even as the funds began to collapse and CAI accepted nearly $110 million in additional investments, the Citigroup affiliates did not disclose the dire condition of the funds and continued to assure investors that they were low-risk, well-capitalized investments with adequate liquidity. Many of the misleading representations made by Citigroup employees were at odds with disclosures made in marketing documents and written materials provided to investors.

"Firms cannot insulate themselves from liability for their employees' misrepresentations by invoking the fine print contained in written disclosures," said Andrew Ceresney, Director of the SEC's Enforcement Division. "Advisers at these Citigroup affiliates were supposed to be looking out for investors' best interests, but falsely assured them they were making safe investments even when the funds were on the brink of disaster."

According to the SEC's order instituting a settled administrative proceeding:

- The ASTA/MAT fund was a municipal arbitrage fund that purchased municipal bonds and used a Treasury or LIBOR swap to hedge interest rate risks.
- The Falcon fund was a multi-strategy fund that invested in ASTA/MAT and other fixed income strategies, such as CDOs, CLOs, and asset-backed securities.
- The funds, both highly leveraged, were sold exclusively to advisory clients of Citigroup Private Bank or Smith Barney by financial advisers associated with CGMI. Both funds were managed by CAI.
- Investors in these funds effectively paid advisory fees for two tiers of investment advice: first from the financial advisers of CGMI and secondly from the fund manager, CAI.
- Neither Falcon nor ASTA/MAT was a low-risk investment akin to a bond alternative as investors were repeatedly told.
- CGMI and CAI failed to control the misrepresentations made to investors as their employees

misleadingly minimized the significant risk of loss resulting from the funds' investment strategy and use of leverage among other things.

- CAI failed to adopt and implement policies and procedures that prevented the financial advisers and fund manager from making contradictory and false representations.

CGMI and CAI consented to the SEC order without admitting or denying the findings that both firms willfully violated Sections 17(a)(2) and (3) of the Securities Act of 1933, GCMI willfully violated Section 206(2) of the Investment Advisers Act of 1940, and CAI willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8. Both firms agreed to be censured and must cease and desist from committing future violations of these provisions.

The SEC's investigation has been conducted by Olivia Zach, Kerri Palen, David Stoelting, and Celeste Chase of the New York Regional Office, and supervised by Sanjay Wadhwa.

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Related Materials

- SEC order