

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION— S.D.N.Y.: Court dismisses securities fraud claims against Citigroup without prejudice, (Mar. 28, 2023)

Securities Regulation Daily Wrap Up

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By Kristin J. Angelino, J.D.

The district court found that allegedly misleading statements and omissions made by defendants about the bank's risk management systems were not actionable.

Citigroup's shareholders failed to plead that the company, three executive officers, and seventeen directors violated Section 10(b) and Rule 10b-5 of the Exchange Act by allegedly making misstatements and omissions about Citigroup's investment in, and compliance with, risk management requirements. In dismissing the consolidated class action complaint, the Southern District of New York found that the complaint failed to identify any actionable alleged misstatements or omissions about Citigroup's risk management or internal control systems. The Southern District also found that the complaint failed to adequately plead scienter. The court denied plaintiffs' request for leave to amend the complaint in the event of its dismissal, but will allow them to make a subsequent motion for leave to amend. (*In re: Citigroup Securities Litigation*, March 24, 2023, Preska, L.).

Citigroup is a Delaware corporation with over \$2.2 trillion in assets that provides financial services and products to consumers, corporations, governments, and institutions worldwide. In October 2020, Citibank, a subsidiary of Citigroup, entered into consent orders with its primary regulators—the Office of the Comptroller of the Currency (the OCC) and the Federal Reserve (the Fed) (collectively, the October 2020 Orders)—pursuant to which both regulators found deficiencies in the bank's risk management and internal controls practices and the OCC issued a \$400 million civil monetary penalty (the CMP).

The original putative class action complaint was filed on October 30, 2020 by The City of Sunrise Firefighters' Pension Fund against Citigroup and the three executive officers. Two separate putative class actions subsequently were filed by two other institutional investors. After certain parties moved to consolidate and to be appointed lead plaintiff, one of the institutional investor plaintiffs voluntarily dismissed its claims without prejudice.

On February 4, 2021, the court consolidated the remaining actions and appointed Public Sector Pension Investment Board as lead plaintiff. A consolidated amended complaint was filed on April 20, 2021 alleging violations of Rule 10b-5 against Citigroup, three executive officers (the "officer defendants"), and seventeen directors, as well as Section 20(a) violations against the officer defendants as control persons. Defendants then moved to dismiss the consolidated complaint arguing that it: (1) failed to identify any actionable statements or omissions; and (2) did not plead a strong inference of scienter.

Material misrepresentations. Although plaintiffs identified nearly 60 alleged misstatements and omissions, defendants argued that all of the statements fall into one of two inactionable categories: (i) statements that are immaterial as a matter of law; and (ii) statements that were not false when spoken and were not rendered false by the 2020 Consent Orders. The court agreed with defendants. In its analysis, the court divided the statements into four categories and explained why it held each category was non-actionable: (1) statements regarding investments in risk management and the design and functioning of Citigroup's risk management system; (2) statements regarding regulatory compliance and progress; (3) risk warnings; and (4) alleged accounting and regulatory false statements and omissions.

In the first category, the court found that plaintiffs' assertion that Citigroup made "meticulously detailed" representations regarding its investments in and design of risk management and internal controls that "gave

comfort” to investors does not withstand scrutiny since the complaint strings together “what are mostly routine, generic, and vague statements that plaintiffs have plucked from various communications across four years and attempted to transform from general to specific by grouping them together.” The court distinguishes the case cited by plaintiffs, *Meyer v. Jinkosolar Holdings Co.*, 761 F.3d 245 (2d Cir. 2014), by stating that the alleged misstatements in *Jinkosolar* were significantly more specific than the statements here. The court added that Citigroup provided repeated and specific cautions in its Annual Reports which defeated any assertion by plaintiffs that defendants made assurances of compliance that would give reasonable investors comfort.

Even if they were not immaterial, the court found that plaintiffs did not adequately allege the falsity of the statements because they either failed to show that the statements were false at the time they were made or failed to identify any specific information available to the defendants at the time the statements were made that should have been disclosed contemporaneously but was not. For example, the court rejected plaintiffs’ argument that the conclusions in the October 2020 Orders regarding deficiencies in the defendant’s risk management systems meant that those systems were inoperable throughout the four-year class action period.

The court found most of the statements in the second category to be either immaterial or inadequately alleged to be false, and it found the rest of the statements to be inactionable opinion or “milquetoast corporate speak” that was too vague or generic for an investor to rely upon.

In the third category, the court found alleged misstatements regarding Citigroup’s risk warnings unactionable since the complaint did not adequately allege that the risk had already materialized at the time the warnings were issued because they were issued prior to the October 2020 Orders.

Regarding the fourth category, plaintiffs asserted misstatements based on (i) Accounting Standards Codification 450 (ASC 450), (ii) SEC Item 303, and (iii) SOX certifications. The court rejected the ASC 450 claim finding that plaintiffs did not allege any concrete facts known to defendants prior to the October 2020 Orders suggesting that GAAP “so clearly required” Citigroup to quantify risk management spending as a loss contingency. The court rejected the Item 303 misstatements finding that the complaint did not adequately allege that the alleged underinvestment in risk management or the eventual October 2020 Orders were “presently known” to the defendants at the relevant times. Finally, the court rejected the alleged SOX certification misstatements finding that plaintiff offered nothing beyond conjecture to suggest that the individual defendants knew—at the time they signed their certifications—of any misrepresentations in Citigroup’s financial statement or deficiencies in the company’s internal controls.

Scienter. The court found that plaintiffs failed to prove scienter by failing to show that the individual defendants either had motive and opportunity to commit the alleged fraud, or strong circumstantial evidence of conscious misbehavior or recklessness. The court rejected plaintiffs’ argument that the individual defendants had motive and opportunity to commit the alleged fraud because the company’s CEO was motivated “to counter negative perceptions about Citigroup’s efficiency ratio” by holding that such motive is common to all corporate officers.

The court also rejected plaintiffs’ argument that the following four families of facts circumstantially evidence scienter by showing the individual defendants’ recklessness: (i) the OCC’s imposition of a \$400 million CMP; (ii) the individual defendants’ alleged claims of involvement with risk management; (iii) the individual defendants’ knowledge of core operations; and (iv) the resignation of two of the company’s corporate executives.

Plaintiffs argued that OCC examiners only impose CMPs for serious misconduct, including misconduct that is reckless. After examining the OCC’s statutory structure and various dictionary definitions, the Court found that it cannot infer that the imposition of a CMP equates to a finding of recklessness. The court rejected the evidence in (ii), finding that plaintiffs had not identified any specific fact the individual defendants possessed that contradicted their statements at the time they were made. The court also rejected plaintiffs’ reliance on the “core operations doctrine” in (iii), finding that even assuming that risk management systems qualify as core operations, the core operations theory constitutes, at most, supplemental support for alleging scienter but does not independently establish it. Finally, the court rejected the evidence in (iv) finding that terminations or resignations of corporate executives, without additional factual allegations linking the termination or resignation to the alleged fraud, are insufficient to establish an inference of scienter.

Section 20(a) claims. Plaintiffs also asserted a control person claim against the individual defendants under Section 20(a) of the Exchange Act. Since the court found that plaintiffs failed to establish a primary violation of the securities laws, their Section 20(a) claim necessarily collapses and was also dismissed.

The case is [No. 1:20-cv-09132](#).

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Companies: Public Sector Pension Investment Board; City of Sunrise Firefighters Pension Fund; City of Sterling Heights General Employees' Retirement System; Anchorage Police & Fire Retirement System; Citigroup Inc.

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