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September 14, 2007

VIA EMAIL
Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

RE: Amendments to Regulation SHO (File No. S7-19-07)

Dear Ms. Morris:

Citigroup Derivatives Markets Inc. ("CDMI")[1] is pleased to have this opportunity to comment on File No. S7-19-07, Amendments to Regulation SHO (the "Proposal") of the Securities and Exchange Commission (the "Commission"). The Proposal would eliminate the options market maker ("OMM") exception in Regulation SHO. CDMI believes that the proposed elimination of the OMM exception would significantly harm the ability of OMMs to provide liquidity and would widen the bid offer quotation for options on the affected securities to the detriment of investors, as detailed below. We therefore urge the Commission to retain the exception as currently written.

As noted in our response to the Commission's previous proposal to narrow the OMM exception,[2] CDMI believes that the nature of options market making requires the ability to sustain short positions in the underlying equity. Currently, CDMI relies on the OMM exception under Regulation SHO to facilitate hedging its options activity. CDMI believes this exception enables it to better service market participants by allowing it to continuously quote and disseminate bids and offers even where it may be difficult to borrow stock.

While the Commission's stated goal of "requiring that all fails to deliver be closed out within a reasonable time period" is worthy, CDMI believes that the elimination of the OMM exception will have the *opposite* effect by reducing liquidity in both the threshold security and the overlaying option, to the ultimate detriment of the investor. Eliminating

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[1] CDMI is a registered options market-maker and member of the Boston Options Exchange, Chicago Board Options Exchange, International Securities Exchange, NYSE Arca and the Philadelphia Stock Exchange. CDMI is also a member of the Chicago Mercantile Exchange, Chicago Board of Trade and New York Mercantile Exchange. CDMI is one of the largest market making firms in the industry and makes a market in substantially all equity, index and ETF option products listed on the various exchanges.

[2] See letter from Steve Keltz, General Counsel, Citigroup Derivatives Markets Inc., dated Sept. 29, 2006 (the "September 2006 Letter"), in response to Amendments to Regulation SHO (File No. S7-12-06).

the OMM exception, as proposed, will place market makers in the position of limiting or stopping making markets on options on threshold or illiquid stocks out of a concern that they will be required to close out hedges, or be unable to establish a cost effective hedge. Without the ability to maintain a consistent hedge, the OMM may decide that it is not rational to make markets in options with threshold securities as the underlying. In addition, if options trading in threshold securities becomes unavailable, market participants seeking to couple a stock position with an option (e.g. covered call writers) may decide not to invest, and liquidity in the underlying stock may be further affected. The uncertainty, time, processing and expense necessary to pre-borrow when effecting a short sale, as well as the uncertainty and expense caused by a close out of a hedge, will by its nature adversely affect the OMMs' pricing of the option. Customers who wish to take positions in threshold securities and hedge such securities with options, and customers that simply want to take a position in options as a surrogate for the underlying security, may well find it inefficient to do so.

The adverse impact the elimination of the OMM exception would have on the liquidity of both options and the underlying threshold securities can further be demonstrated by examining the differences between OMMs and market makers in the cash markets. In particular, risks that are present in the options business may not be a significant factor in cash market market-making. In the cash market, market makers are concerned, among other things, about imbalances in the number of buyers and sellers. While OMMs have the same concern about the size of the imbalance (more sellers than buyers of the underlying equity), they also are focused on how they will carry that risk and the cost of that carry for the term of the options to which they have committed. For example, OMMs facilitate incoming order flow in LEAP option contracts that can expire up to two (2) years from the time the option is traded. An OMM must maintain a hedge for an extended period of time; often times the only available and/or economically feasible hedge is the underlying security. Therefore, it is critical for an OMM to have certainty when hedging its exposure that such hedge will not be closed out.

Moreover, the equity component of option value (the delta or volatility component) is variable over the life of an option. This means that during the term of the hedging of the risk of an equity option, an OMM will likely have to buy and sell (and/or add to an existing short position) the underlying equity. Concern about when a security may be closed out, and the cost of effecting a close out of that equity adds another uncertain factor to the analysis of the business risk of an OMM, skewing the pricing of the option.

For these reasons, CDMI believes it is inappropriate for the Commission to eliminate the OMM exception on the basis that all market makers (cash and options) should be treated equally. We believe this significant difference, along with the factors we set out in the September 2006 Letter, justify the availability of an exemption for options market-makers. However, if the Commission determines to eliminate the current exemption, CDMI urges the Commission to adopt Alternative 1 as its replacement. CDMI believes that a 35 settlement day buy-in period will provide some flexibility for an OMM to seek an alternative hedge in a more orderly manner resulting in a more efficient options market than would otherwise be possible were the OMM exception eliminated entirely.

Short selling by OMMs to establish a hedge on options positions is not an abusive practice. Rather it is a tool used by OMMs to manage risk in a manner that ensures that the markets for options and the securities to which they relate remain efficient. Eliminating the market maker exception will not eliminate abusive short selling, but will reduce liquidity to the ultimate detriment of the investing public. For these reasons, we urge the Commission not to adopt the Proposal and to retain the OMM exception. If the Commission is determined to eliminate the OMM exception, we would request that, at a minimum, the Commission adopt the first alternative set out in the Proposal.

We appreciate the opportunity to respond to the Proposal. Please contact me at 952-475-5607 if you have any questions.

Sincerely,

Charles Mogilevsky
Managing Director
Citigroup Derivatives Markets Inc.