citigroup

September 29, 2006

VIA EMAIL

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

Dear Ms. Morris:

Citigroup Derivatives Markets Inc. ("CDMI") [1] is pleased to have this opportunity to comment on File No. S7-12-06, Amendments to Regulation SHO (the "Proposal"). Among other things, the Proposal would narrow the options market maker exception in Regulation SHO. CDMI's comments are limited to this portion of the Proposal. We believe that the proposed narrowing of the options market maker exception would significantly harm the ability of options market makers 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.

CDMI believes that the proposed narrowing of the options market-maker exception does not adequately consider the nature of options market maker hedging activities. Currently, CDMI relies on the options market-maker 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 certain stock. Because the activities of an options market maker are fluid (i.e. continuous trading based on disseminated market quotes), CDMI does not hedge on a trade-by-trade or option-by-option basis. Rather, CDMI calculates an appropriate hedge based on the perceived risk of the overall option positions and without matching a stock hedge to a particular option. This means that a liquidation or expiration of an options contract within the overall portfolio would not necessarily cause a market maker to readjust its hedge for the portfolio as a whole.

Unfortunately, if the Proposal is approved a market maker would no longer be exempt from a buy in those instances where the options position that triggered the exemption expires or is liquidated even where such action would not affect the market maker's overall risk profile. Market makers typically facilitate an investor(s) rolling of an existing options position to either a different strike price within the same expiration month or to a future month as expiration approaches. In the absence of the existing market maker exception, since an expiring leg of a transaction triggered the exemption, the exemption will not be available to support the new leg of the trade and the market maker will be required to buy in the short position and/or pre-borrow to maintain a hedge, even

[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.

though the overall position has changed very little from a risk perspective. A market maker should be able to accommodate the transaction by liquidating the original option position (or having it expire) and establish a new options position without making unnecessary and potentially costly and time-consuming changes to its portfolio.

If the Proposal is approved and market makers are required to identify a stock hedge to a particular options position, liquidity in threshold securities will be adversely impacted, to the ultimate detriment of the investor. Requiring a market maker to unnecessarily close out a fail to deliver of a hedge of a pre-existing options position, or to pre-borrow shares as a result of its not executing the closeout, would cause market makers to be reluctant to make markets in threshold securities, resulting in quoting wider option spreads in such securities. The uncertainty, time, processing and expense necessary to pre-borrow and effect a short sale will by its nature affect the market makers' pricing in the option.

CDMI believes that tighter option spreads increase liquidity and competitive pricing to the benefit of the investing public. Narrowing the market maker exception, as proposed, will place market makers in the position of seriously considering whether to limit or cease to make markets on options on threshold or illiquid stocks out of a concern that they will required to unnecessarily close out hedges or unable to establish a cost effective hedge. Without the ability to maintain a consistent hedge, the market maker may decide that it is not rational to make markets in threshold securities. 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. Customers who legitimately 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.

Short selling by market makers is not an abusive practice. Rather it is a tool used by market makers to insure 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 have a negative impact on the investing public. Since CDMI believes that the proposed options market maker exception will reduce liquidity to the detriment of the market, we believe that such proposed exception should not be approved.

We appreciate the opportunity to respond to the Proposal. Please contact me at 212.723.3837 if you have any questions.

Sincerely,

Steve Keltz

Steve Keltz
General Counsel