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VIA FEDERAL EXPRESS AND ELECTRONIC MAIL

February 18, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Proposed Amendments to Regulation M (File No. S7-41-04)

Dear Mr. Katz:

Citigroup Global Markets, Inc. ("Citigroup")[1] appreciates the opportunity to comment on the amendments to Regulation M[2], proposed by the Securities and Exchange Commission. In general, Citigroup supports most of the proposed amendments, although we believe the changes to Rule 106 are overbroad. We strongly believe that the proposed amendments to Rule 104 concerning penalty bids and syndicate short covering are unnecessary.

Regulation M, adopted by the Commission in 1997, was the result of a rigorous rulemaking process that eased the regulatory burdens on offering participants by replacing the old "10-b" trading practices rules with a set of six rules (Rules 101-107) that contained exceptions to allow for certain activity to continue during a distribution of securities. The Commission struck a fine balance between the need to prevent manipulative conduct in connection with U.S. securities offerings, thus ensuring confidence in our capital markets, and the need to promote efficiency and competitiveness. However, in the last few years, activities of underwriters in connection with initial public offerings ("IPOs") have come into question and the SEC proposed to amend Regulation M in order to proscribe these abuses. In considering the proposed amendments, we ask that the Commission use the same level of rigorous scrutiny it used when adopting Regulation M originally, and to avoid the temptation to adopt overbroad regulation in response to the recent abuses in the allocation of IPOs.

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1 Citigroup is a global financial services firm that provides investment banking, securities and commodities trading, asset management, and advisory, research and brokerage services to customers. It is a registered market maker in approximately 4,000 Nasdaq, exchange-listed, bulletin board, and over-the-counter securities, is a member of the National Association of Securities Dealers, Inc. ("NASD"), the New York Stock Exchange, Inc. ("NYSE"), and a number of other national securities exchanges.

2 See Commission Release Nos. 33-8511; 34-50831; IC-26691 (December 9, 2004)(the "Release").

Citigroup supports the following: (1) the amendments to Rules 100, 101 and 102, to update the ADTV and public float value; (2) the amendment of the Rule 100 definition of "restricted period" for IPOs; (3) the amendment of Rule 101's *de minimis* exception to require recordkeeping; and (4) the amendment to Rule 104(j)(2) to include reference securities in the exception for Rule 144A securities. Therefore, we are limiting our comments to the proposed amendments to Rule 104 to eliminate penalty bids and to require disclosure of syndicate covering bids, and to Rule 106 to expressly prohibit the conditioning of an allocation on the receipt of consideration in addition to the stated offering consideration, all of which Citigroup believes are overbroad and harmful to the capital formation process.

Elimination of Penalty Bids

The use of a penalty bid to facilitate an orderly market has long been recognized as a legitimate practice, and it was so recognized by the Commission in originally adopting Regulation M. In addition, the Commission has examined the use of penalty bids through its examination and enforcement process and has continued to allow their use by underwriters as a means to ensure that shares of offerings are placed with investors, not short-term profit takers. The proposed amendment to Rule 102 would prohibit completely the use of penalty bids. It is not clear what the policy goal is in proposing a total prohibition. The potential for misuse of penalty bids can be addressed by prohibiting their application in an uneven or discriminatory manner, as the NYSE and NASD each have proposed in their rules governing pricing and allocation practices.[3]

Penalty bids are rarely used outside the context of the offerings of closed end funds. The market for closed end funds consists primarily of retail clients seeking a long-term investment vehicle rather than investors seeking short-term trading profits. The use of penalty bids in these offerings can be particularly effective in preventing disruptions to the aftermarket trading of these securities that short-term holders, or "flippers," could cause. If the Commission believes that penalty bids should be generally eliminated, rather than limited as the NYSE and NASD propose, Citigroup requests that the Commission continue to permit their use in connection with offerings made by an investment company under the Investment Company Act of 1940.

Disclosure of Syndicate Short Covering Bids

Proposed Rule 104 would require the disclosure of all syndicate short covering bids. The over-allotment of a securities offering has been recognized as a legitimate means for an underwriting syndicate to create buying power for the purpose of limiting aftermarket price volatility. Aftermarket trading can be volatile as the market tries to balance buying and selling interests to reach a resting price for the security. Legitimate buying activity by the syndicate during this period serves the regulatory purpose of providing liquidity in order to provide a fair and orderly aftermarket. If the syndicate were forced to reveal to market participants, including accounts engaged in short-term and speculative trading strategies, exactly when it was engaging in short

[3] *See* Commission Release No. 34-50896 (File Nos. SR-NYSE-2004-12; SR-NASD-2003-140) (December 20, 2004)(the "SRO Release").

covering activity in the open market, it could undermine the syndicate's ability to facilitate an orderly aftermarket. If a bid by the syndicate was disclosed as such, professional traders could take advantage of this buying activity in order to gain short-term profits. We believe this would only result in increased price volatility that favors market opportunists and harms long-term investors.[4]

In the proposing release, the Commission compares syndicate covering to stabilization. We are concerned that the Commission has blurred the distinction between stabilization and syndicate short covering that it recognized in originally adopting Regulation M when it required real-time disclosure of a stabilizing bid only. Whether effected to close out a covered short position or a naked short position, syndicate covering transactions may have the effect of preventing or retarding a decline in the market price of the securities, and may stabilize, maintain or otherwise affect the market price of the securities in the immediate aftermarket. The Commission has recognized that syndicate short covering may act to support the price of the offered security in the aftermarket, and recognizes that such "support" acts as a counterbalance to the downward pressure from aftermarket selling activity that could adversely affect the investors who have purchased in the offering. However, unlike stabilization under Rule 104, which is used before a distribution is complete to maintain the stock price and involves contemporaneous public disclosure, syndicate short covering is used after an offering is priced and distributed. The need for real-time public disclosure of the syndicate bid at that time is unnecessary.

The prospectus for every offering discloses the fact that the underwriters may engage in short sales and short covering transactions. If the Commission believes that this disclosure is insufficient, Citigroup proposes that additional disclosure be mandated after the completion of short covering activities, similar to the announcements made by issuers after an over-allotment option is exercised. Such post-syndicate disclosure would allow underwriters to continue to facilitate an orderly aftermarket, while providing investors with full disclosure as appropriate.

Citigroup also asks that the Commission look at the recently adopted Market Abuse Directive from the European Union. As originally proposed, it would have required contemporaneous disclosure of short covering bids. However, this approach was rejected in favor of a rule requiring post-syndicate disclosure.[5]

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4 It should be noted that a bid submitted in accordance with Rule 104 is seen only by market professionals (the specialist or a Nasdaq market maker) and not by retail investors. Therefore, requiring contemporaneous disclosure of a syndicate covering bid to the market would give no additional information to retail investors than they receive currently by way of the offering prospectus. Other methods of disclosure that might reach retail investors, such as by means of a press release or web posting, would likely not provide any more timely or meaningful disclosure and would likely prove cumbersome since short covering is a dynamic process which may be commenced and stopped several times in any given trading day.

5 The Securities Industry Association ("SIA") has also made this observation in its comment letter with respect to the Release and further discusses a similar rule promulgated by the Hong Kong Securities and Futures Commission. (*See* Letter from John Faulkner, Chairman, SIA Capital Markets Committee, dated February 15, 2005).

The Amendment to Rule 106 is Overbroad

Proposed Rule 106 would prohibit expressly the conditioning of an allocation in an offering on the receipt of consideration in addition to the stated offering consideration. Citigroup strongly agrees that inappropriate *quid pro quo* arrangements should be prohibited. However, the prohibition as proposed is overbroad and may result in prohibiting legitimate activity. In addition, Citigroup believes this rule should specifically apply to IPO offerings, rather than all offerings. The abuses that the rule is seeking to prohibit have occurred in IPO offerings, and the rule should be tailored to address those abuses. Application of the rule outside of the “hot” IPO context is unnecessary and could be expensive to implement, given that most firms’ surveillance programs are geared toward IPOs in compliance with the Voluntary Initiative. To broaden the prohibition to other offerings could be quite costly.

By using the words “any consideration,” the Commission has failed to sufficiently craft a rule directed to specific impermissible conduct. Citigroup agrees that IPO allocations premised on excessive commissions, promises of aftermarket purchases or future banking business are clearly inappropriate and need to be expressly prohibited. However, Citigroup is concerned that the rule as proposed could interfere with legitimate customer relationships and the ability of an underwriter to allocate offerings based upon permissible criteria that may be relationship-based. Citigroup urges the Commission to more narrowly focus the proposed amendment on IPO market abuses. We suggest that the Commission look at the SRO rule proposals (and the SIA letter submitted to the Commission commenting on them[6]), which specifically prohibit excessive commissions and spinning. Allocation practices (other than the prohibition against inducements of after market purchases) are more properly regulated by the SROs.

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Citigroup thanks the Commission for the opportunity to comment on these important amendments to Regulation M and hopes that the dialogue on these and other important issues continues to strengthen the capital markets. If you have any questions, please do not hesitate to contact the undersigned at (212) 816-8894.

Very truly yours,

Edward F. Greene

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[6] Letter from John Faulkner, Chairman, SIA Capital Markets Committee, dated February 15, 2005, with respect to the SRO Release.

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Annette L. Nazareth, Director, Division of Market Regulation
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