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corporate and
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February 13, 2006

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

RE: NYSE Proposed Rule Change to Rule 431 and Rule 726 (SR-NYSE-2005-93)

Dear Ms. Morris:

Citigroup Global Markets Inc. ("CGMI") is pleased to respond to the New York Stock Exchange's ("NYSE") proposed changes to its Rule 431 and Rule 726 (the "Proposal"). CGMI agrees that the "benefit of portfolio margining is to efficiently set levels of margin that reflect historical moves that more precisely reflects actual net risk of all positions in the account."[1] By allowing firms to utilize portfolio margining in determining their margin requirements under Rule 431, we believe the Proposal represents a positive first step.

Unfortunately, the Proposal as currently drafted raises significant issues that will prevent many "eligible participants" (as defined in the Proposal) from adopting the alternative portfolio margining approach. CGMI believes that, by more accurately aligning margin requirements with actual risk, portfolio margining will have a positive effect on the financial marketplace by reducing systemic risk and increasing liquidity, leading to more efficient markets. Our comments below suggest changes to the Proposal that we believe will lead to greater use by eligible participants of portfolio margining under Rule 431, to the ultimate benefit of the financial markets.

Additional Asset Classes Should be Eligible For Portfolio Margining

CGMI participated in the preparation of the letter by the Securities Industry Association (the "SIA Letter") in response to the Proposal and generally supports the analysis and views set forth in the SIA Letter. In particular, we join the SIA in urging the NYSE not to delay further amendments to Rule 431 that will further broaden the asset classes eligible for portfolio

[1] Proposal, p. 3593.

margining. We strongly support including a broad range of assets, and in particular including all listed and OTC equity securities, within the scope of the portfolio margining approach offered under Rule 431.

Proprietary Theoretical Pricing Models Should be Allowed

The Proposal currently contemplates allowing firms to calculate theoretical gains and losses on which they would base their portfolio margin requirements through the use of a theoretical pricing model that must be approved by a Designated Examining Authority ("DEA") and reviewed by the Commission. The Proposal also notes that "the theoretical model utilized by the Options Clearing Corporation ("OCC") is the only model qualified pursuant to the Commission's Net Capital Rule. All member organizations shall obtain their theoretical values from the OCC."[2]

We believe that requiring firms to utilize a specific third-party theoretical pricing model is inappropriate. Eligible participants should not be forced to purchase a service offered by only one institution in order to be able to benefit from portfolio margining. This is particularly true for sophisticated member firms, who have the capability to develop theoretical pricing models that would appropriately reflect the theoretical gains and losses for "eligible products" (as defined in the Proposal).

By requiring member firms to utilize a third-party theoretical pricing model, the Proposal also runs counter to several regulatory developments allowing firms more flexibility in using proprietary mathematical models to meet certain regulatory requirements. One notable example is the Commission's recent "consolidated supervised entity" amendment to Rule 15c3-1 under the Exchange Act (the "CSE Amendment"). Under the CSE Amendment, the Commission allows sophisticated firms[3] to use proprietary mathematical models to calculate regulatory capital under Rule 15c3-1, as amended by the CSE Amendment. As the proposing release for the CSE Amendment notes, allowing mathematical-model based capital calculations aligns the Net Capital Rule with other Commission rules[4] as well as with the Basel Accord.[5] Given that regulatory capital requirements and margin requirements are both aimed at protecting the financial condition of broker-dealers,[6] it is unclear why proprietary mathematical models are allowed for purposes of calculating regulatory capital but not margin.

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[2] Rule 431(g)(3) (as amended by the Proposal), p. 3587.
[3] Firms must meet certain net capital requirements before they may use the alternative net capital approach under Rule 15c3-1, as amended by the CSE Amendment, as described on p 3.
[4] "The Commission permits broker-dealers that limit their business to OTC derivatives trading and ancillary cash and portfolio management activities ("OTC derivatives dealers") to calculate capital charges based on VaR models.", proposing release for CSE Amendment, 68 FR 62875, footnote 22 [describing Exchange Rule 15c3-4].
[5] "Our proposal incorporates a capital computation for the CSE that is designed to be consistent with the Basel Standards.", proposing release for CSE Amendment, 68 FR 62874.
[6] While regulatory capital requirements seek to ensure a sufficient level of capital at a broker-dealer, particularly in order to ensure a orderly liquidation if necessary, margin requirements seek to restrict the amount of credit a broker-dealer may extend. The common purpose of each set of rules is to protect the financial condition of the broker-dealer; this common purpose is reflected in several securities regulations: see, e.g. Exchange Act Rule 3a40-1 (designating both SRO margin rules and net capital rule 15c3-1, among others, as "financial responsibility rules"),

We believe that sophisticated member firms should be able to utilize proprietary theoretical pricing models to estimate potential loss in connection with establishing margin requirements for a portfolio of eligible securities, subject to approval by such firms' DEA and the Commission. Further, we believe that such proprietary internal models are capable of greater sophistication than a third-party model. In particular, internal models would better be able to accommodate an expanded class of instruments and take into account additional factors to better estimate potential loss for such a sophisticated firm's portfolio. Allowing sophisticated member firms to use their own internal models in calculating portfolio margin will result in a more accurate reflection of risks in a portfolio than through the use of a third-party model, ultimately resulting in lower systemic risk.

In order to ensure a requisite level of sophistication and creditworthiness, member firms should be required to meet the same minimum capital requirements as under the CSE Amendment – specifically, firms should be required to maintain tentative net capital of at least $1 billion, and maintain net capital of at least $500 million. This safeguard would address any potential issues regarding the creditworthiness or sophistication of a member firm utilizing its own theoretical pricing model.[7]

The Proposal Should Include OTC Eligible Products

CGMI believes that eligible participants should be able to apply portfolio margining to both listed *and* over-the-counter ("OTC") U.S. index options, securities futures contracts and single stock options (defined as "eligible products" under the Proposal). By limiting the application of portfolio margining to listed eligible products, the Proposal unduly limits its application to a relatively narrow universe of asset classes, further preventing firms from adopting the portfolio margining approach there under. As noted above, this is unfortunate, not only because it will prevent member firms and their customers from reaping the benefits of portfolio margining, but also will have the added effect of preventing increased liquidity in the financial markets.

Operational and Regulatory Issues Regarding Cross-Margining Must be Addressed

While CGMI applauds the NYSE for allowing cross-margining of eligible products with "related instruments" (as defined in the Proposal), we do not believe the cross-margining aspect of the Proposal is feasible as currently written. In particular, we believe that operational and regulatory issues pose obstacles for any broker-dealer seeking to utilize cross-margining under the Proposal. Specifically, it would be operationally difficult for CGMI, which currently holds its futures positions in a segregated customer futures account to move such positions to a

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Rule 15c3-1(c)(2)(xii) (net capital rule provision providing that a broker-dealer that fails to collect margin as required by applicable SRO rules must reduce its regulatory capital to the extent of such failure).

[7] As the proposing release for the CSE Amendment notes, "Raising the minimum tentative net capital requirement to $1 billion and net capital requirement to $500 million is one way to ensure that firms that use the alternative capital computation maintain sufficient capital reserves to account for these other risks. In addition, based on our experience, firms must have this scale of operations in order to have developed internal risk management control systems necessary to support reliable VaR computations," 68 FR 62875.

securities account, as would be required under the Proposal. Even if such operational issues were addressed, such transfer could not take place unless the CFTC granted relief from the provisions of Section 4d(a)(2) of the Commodity Exchange Act, which generally requires that customer funds and positions (such as those pledged as margin collateral) be segregated in a customer futures account. We encourage the Commission and NYSE to consult with the CFTC and other affected parties in order to address these issues.

We appreciate the opportunity to respond to the Proposal. Please contact me at 212.723.4994 if you have any questions.

Sincerely,

/s/ Severino Renna

Severino Renna
Director

CC:

Reuben Jeffrey, Chairman, Commodity Futures Trading Commission
Michael Macchiaroli, Associate Director, Division of Market Regulation, Securities and Exchange Commission
Grace Vogel, Executive Vice President, Member Firm Regulation, New York Stock Exchange
Andrew Naughton, Executive Vice President and Chief Financial Officer, Options Clearing Corporation
Richard Lewandowski, Vice President, Regulatory Services, Chicago Board Options Exchange
Jerry Quinn, Vice President and Associate General Counsel, Securities Industry Association
Barbara Wierzynski, Executive Vice President and General Counsel, Futures Industry Association